



U.S. Department of the Interior
Office of Inspector General

AUDIT REPORT

**INTERFUND LOANS AND
FEDERAL GRANT BALANCES,
GOVERNMENT OF THE VIRGIN ISLANDS**

**REPORT NO. 98-I-670
SEPTEMBER 1998**



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20240

SEP 9 1998

Honorable Roy L. Schneider
Governor of the Virgin Islands
No. 21 Kongens Gade
Charlotte Amalie, Virgin Islands 00802

Subject: Audit Report on **Interfund** Loans and Federal Grant Balances, Government of the Virgin Islands (NO. 98-I-670)

Dear Governor Schneider:

This report presents the results of our review of **interfund** loans and Federal grant balances of the Government of the Virgin Islands. The objective of our audit, as amended, was to determine (1) all amounts borrowed by the General Fund **from** special fund accounts during fiscal years 1995, 1996, and 1997 and (2) the outstanding balances of such interfund loans and the unobligated balances of Federal grant accounts. This report also updates preliminary information presented in our advisory report "Status of **Interfund** Loans and Other Obligations, Government of the Virgin Islands" (No. 98-I-187), which was issued on December 22, 1997.

Based on our review, we concluded that (1) the Government, as of September 30, 1997, had outstanding operations-related obligations of about \$588 million; (2) complete, current, and reliable information on the balances of Federal grants awarded to the Government was not readily available; and (3) the Government had not taken adequate steps to correct long-standing financial management problems that had an adverse impact on its financial condition. Specially, we found that:

- The Government, as of September 30, 1997, had outstanding operations-related obligations (excluding bonded debt) totaling \$588 million as follows: \$120 million for unauthorized and unrecorded interfund loans; \$21 million for authorized and recorded **interfund** loans; \$150 million for disaster-related loans received from the Federal Emergency Management Agency after Hurricanes Hugo and Marilyn; \$14 1 million for retroactive salary increases and fringe benefits for fiscal years 199 1 through 1997; \$76 million for income tax refunds for tax years 1994 through 1996; at least \$67 million for goods and services provided by approximately 4,000 vendors; and \$13 million for the Government Employees Retirement System for the Early Retirement Incentive, Training and Promotion Act of 1994 and regular retirement contributions for September 1997. In January 1998, the Legislature approved and the Governor signed into law Act No. 6197, which authorized the Government to obtain a short-term (1 O-month) loan of \$106 million to pay \$64 million in outstanding income tax

refunds and \$42 million in outstanding vendor invoices. Regarding the Government's overall financial condition, the effect of Act No. 6197 was to convert accounts payable of \$106 million into loans payable of \$106 million that would accrue interest at the rate of 6.9 percent annually. The Government said that it intended to liquidate the \$106 million loan from the proceeds of bonds that were issued in May 1998.

- Although the Virgin Islands Office of Management and Budget maintained a tracking system for Federal grants received by the Government, this system relied on information provided by individual operating agencies of the Government and was not current or reliable. Financial information on Federal grants contained in the Financial Management System operated by the Department of Finance also was not current or reliable. Our review of Federal grant accounting practices at the four Government agencies that receive the largest amount of Federal grant funds on a recurring annual basis disclosed that the Department of Health and the Department of Human Services generally maintained effective control over their grant funds and did not have any material amounts of unobligated grant funds; the Department of Education did not liquidate outstanding encumbrances or submit grant Financial Status Reports for its fiscal year 1997 consolidated block grant (\$17 million) within the time frames required by the Code of Federal Regulations; and the Department of Public Works did not fully use grants of about \$38.1 million it had received during the period of 1984 to 1997 for the establishment and operation of the public bus transportation system (\$6.6 million), the purchase of buses for elderly and handicapped persons (\$0.8 million), various environmental protection projects (\$17 million), and various highway improvement and construction projects (\$13.7 million).

- Although the Government has made some improvements in its operations, long-standing problems still existed in the areas of overall financial management, expenditure control, revenue collection, and program operations. We believe that these long-standing problems have a negative impact on the Government's overall financial condition and that significant improvements in these areas could have been achieved if the Government had implemented audit recommendations made by the Office of Inspector General and the Virgin Islands Bureau of Audit and Control.

To correct these conditions, we have made 20 recommendations that, although they will not solve the Government's immediate financial crisis, could provide a basis for the Government to initiate long-term improvements in its daily operations and in its overall financial condition.

On June 4, 1998, we discussed a preliminary draft of this report with the Commissioner and other officials of the Department of Finance, who generally concurred with the recommendations but disagreed with our conclusion that, as a result of the unrecorded **interfund** loans of \$120 million, Federal funds may have been used to cover an overdraft in the Special and Other Funds bank account. On June 22, 1998, the Commissioner of Finance also provided us with a written response (Appendix 5) to the preliminary **draft** report, which disagreed with our conclusions that (1) unrecorded **interfund** loans of \$120 million were not authorized by the Legislature and (2) Federal funds may have been used to cover an overdraft

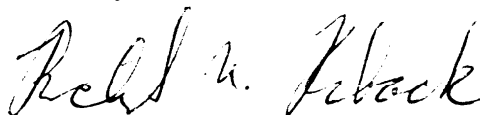
in the Special and Other Funds bank account. In its response, Finance also stated that it had begun actions to implement several of the audit recommendations.

On June 30, 1998, we transmitted the draft of this report to the Governor of the Virgin Islands requesting a response by August 7, 1998. On August 20, 1998, we received the response from the Governor that was dated August 7, 1998. Based on the response received, we consider 6 of the report's 20 recommendations resolved and implemented, 3 recommendations unresolved, and request additional information for 11 recommendations (see Appendix 6).

The Inspector General Act, Public Law 95-452, Section 5(a)(3), as amended, requires semiannual reporting to the U.S. Congress on all audit reports issued, the monetary impact of audit findings (Appendix 1), actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

In view of the above, please provide a response, as required by Public Law 97-357, to this report by October 9, 1998. The response should be addressed to Caribbean Office, Federal Building - Room 207, Charlotte Amalie, Virgin Islands 00802. The response should provide the information requested in Appendix 6.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard N. Reback". The signature is fluid and cursive, with the first name "Richard" and last name "Reback" clearly distinguishable.

Richard N. Reback
Acting Inspector General

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INTRODUCTION

BACKGROUND

The Government has three main checking accounts: the General Fund bank account (at the Chase Manhattan Bank), which is used for the general revenues and operating expenses of the Government; the Special and Other Funds bank account (at the **Banco** Popular de Puerto Rico), which is used for revenues and expenses related to special programs such as Federal grant programs and a variety of specially funded local programs; and the Payroll Fund bank account (at the Chase Manhattan Bank), which is a “zero balance” clearing account. Each pay period, sufficient monies from the General Fund and the special funds are deposited into the Payroll Fund bank account and used to pay employee salaries and other related payroll expenses, such as withholding and Federal Insurance Contributions Act (FICA) taxes, retirement contributions, and health insurance premiums.

In accordance with generally accepted government accounting principles, the General Fund and each of the Government’s special funds should have complete sets of general ledger accounts, which consist of balance sheet accounts (assets, liabilities, and equities) and operating accounts (revenues and expenditures). These general ledger accounts are maintained in the computerized Financial Management System maintained by the Department of Finance and are used as the basis for preparing annual financial statements of the Government. Generally accepted government accounting principles require the issuance of a comprehensive annual financial report, and the Single Audit Act of 1984 requires that audited financial statements be issued as part of an overall audit of all Federal financial assistance within 12 months of the end of each fiscal year. However, the most recent audited financial statements and single audit report issued by the Government were for the fiscal year ended September 30, 1994.

Interfund Loans

Since at least March 1995, the Government of the Virgin Islands has experienced financial difficulties that have resulted in cash flow problems and the need for interfund loans to meet regular operating expenses. In March 1995, the Legislature, anticipating that the Government of the Virgin Islands would not be able to meet payroll costs in March and August 1995 (which had three Government paydays), passed Act No. 6068, which the Governor signed into law. The Act authorized the Governor, through the Commissioner of Finance, “to borrow, on a temporary, short-term basis, an amount not to exceed \$15 million for the exclusive purpose of meeting the recurring payroll cost of the Government of the Virgin Islands when the Governor determines that the revenues collected are insufficient to cover any payroll which comes due during such insufficiency.” The Act further stated, “No short-term loan may be made which cannot be retired with revenues collected for the fiscal year in which it was obtained.” The Act had an expiration date of September 30, 1995. However, in November 1996, the Legislature passed Act No. 6128, which the Governor

signed into law and which (among other provisions) retroactively extended the period to repay any funds borrowed under the authority of Act No. 6068 to September 30, 1997.

Based on the authority provided by Act No. 6068, the Government, during the period of March to September 1995, borrowed a total of \$20 million¹ from special fund accounts to meet its payroll obligations. Of the \$20 million borrowed, only \$8.5 million had been repaid (\$5 million in June 1995 and \$3.5 million in July 1997) as of September 30, 1997. Thus, \$11.5 million remained outstanding.

Despite the borrowing authority provided by Act No. 6068, the Government has not been able to meet its operating expenses with current operating revenues. This situation was exacerbated by a general economic downturn and by the impact of Hurricanes Marilyn in September 1995 and Bertha in July 1996. The fiscal year 1998 Executive Budget consisted of estimated General Fund revenues totaling \$361.9 million and General Fund expenditures totaling \$459.5 million, or a revenue shortfall of \$97.6 million.² Also, the payment of any portion of the outstanding obligations discussed in this report would increase that shortfall accordingly.

Federal Grants

The Federal Grants Management Unit within the Virgin Islands Office of Management and Budget is responsible for (1) monitoring recipient compliance with financial and performance objectives of Federal grant awards and (2) developing programs and policies to ensure the effective application of Federal funds. To comply with these responsibilities, the Federal Grants Management Unit maintains a grant tracking system that is based on information that the Unit requests from Government agencies on a quarterly basis regarding grant award, drawdown, and balance amounts. Federal Grants Management Unit officials told us that they requested this information directly from the grantee agencies because they did not consider information contained in the Government's Financial Management System to be accurate, current, complete, and reliable. The grant tracking system is used by the Office of Management and Budget for budget and grant management purposes.

¹Department of Finance officials stated that although a total amount of \$20 million was borrowed in accordance with Act No. 6068, the outstanding amount at any time never exceeded the \$15 million limit contained in the Act.

²To balance the budget, the fiscal year 1998 Executive Budget also included, as General Fund revenue sources, \$18.1 million in contributions from other funds, \$33 million from privatization of the Virgin Islands Water and Power Authority, \$27 million from a Federal Emergency Management Agency (FEMA) Community Disaster Loan, \$4.5 million from a FEMA State Share Loan, and \$15 million from "economic stimulus investments." However, as of January 31, 1998, except for the **interfund** contributions and the release of \$12 million by FEMA for the Community Disaster Loan, these supplemental revenue sources did not appear to be firm commitments because the privatization of the Water and Power Authority had not been approved by the Legislature and private investments in new casino resorts and other similar projects had not materialized. Additionally, the fiscal year 1998 General Fund appropriation acts passed by the Legislature totaled \$460.9 million rather than the \$459.5 million estimated in the Executive Budget.

As of March 1997 (the most recent data available from the Federal Grants Management Unit as of January 31, 1998), the grant tracking system contained information on approximately 400 Federal grants, totaling \$427 million (exclusive of long-term Federal grants for health facilities construction and Federal Emergency Management Agency (FEMA) disaster loans), that were awarded during fiscal years 1993 through 1997. In addition, drawdowns reported against the grants totaled \$272 million, leaving reported balances totaling \$155 million available for drawdown. However, as discussed in Finding B, these grant balances were not necessarily available for expenditure by the Government because the amounts were inaccurate or the funds were committed for specific projects or programs.

OBJECTIVE AND SCOPE

The original objective of our audit was to determine the status of interfund loans and other outstanding obligations of the Government as of September 30, 1997, and the unobligated balances of Federal grant accounts as of March 31, 1997. However, because of inappropriate **interfund** loan transfers found during our fieldwork, our objective was amended to determine (1) all the amounts borrowed by the General Fund from special fund accounts during fiscal years 1995, 1996, and 1997 and (2) the outstanding balances of such **interfund** loans and the unobligated balances of Federal grant accounts. With respect to the interfund loans portion of the audit, the scope of the audit was extended to January 31, 1998, to consider the \$106 million loan negotiated by the Government to pay income tax refunds and vendor invoices. With respect to the Federal grants portion of the audit, the scope of the audit was qualified to the extent that we did not audit the costs claimed against Federal-grants to determine whether these costs were reasonable, allowable, or allocable in accordance with grant terms and conditions because the objective of that portion of the audit was limited to determining the unobligated balances of grants. We generally relied on information compiled by the Virgin Islands Office of Management and Budget but expanded the scope of our review to include limited testing of Federal grant transactions at the Departments of Health, Human Services, Education, and Public Works (the four Government agencies that receive the largest amount of Federal grants on a recurring annual basis). The audit was conducted from September 1997 through January 1998 at the Department of Finance, the Office of Management and Budget, the Bureau of Internal Revenue, the Government Employees Retirement System, and the four largest grantee agencies.

Our review was made, as applicable, in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

We included an evaluation of internal controls to the extent we considered necessary to accomplish the audit objective. The internal control weaknesses identified were related to the recording of **interfund** loans and the establishment of a grants management system to monitor the financial and compliance aspects of Federal grants. The control weaknesses are discussed in the Findings and Recommendations section of this report. The recommendations, if implemented, should improve the internal controls in these areas.

PRIOR AUDIT COVERAGE

Since November 1985, the Office of Inspector General has issued five reports on financial management within the Government of the Virgin Islands as follows:

- The December 1997 advisory report “Status of **Interfund** Loans and Other Obligations, Government of the Virgin Islands” (No. 98-I-187) was issued to provide Government of the Virgin Islands officials with preliminary information on the status of **interfund** loans and other outstanding obligations to allow them to make informed decisions on the Government’s finances. Although the advisory report did not contain any recommendations, the Governor was provided with the opportunity to respond to the advisory report before it was issued in final form. However, the Governor did not provide a response until after the final report was issued. The Governor’s response to the advisory report (Appendix 3) and the Office of Inspector General’s reply to the Governor (Appendix 4) are discussed in Finding A of this report.

- The September 1994 special report “Status of Improvements in Financial Management and Program Operations, Government of the Virgin Islands” (No. 94-I- 1284) (1) presented a summary of long-standing problems in financial management, expenditure control, revenue collection, and program operations; (2) recognized the corrective actions taken by the Government of the Virgin Islands and the then-Office of Territorial and International Affairs (now the Office of Insular Affairs) of the U.S. Department of the Interior to address those problems; and (3) provided the Government with a series of suggested goals and corrective actions to address the remaining problem areas. The suggested improvement goals are discussed in Finding C of this report.

- The April 1994 special report “Bonded Debt of the Government of the Virgin Islands and its Autonomous Agencies” (No. 94-I-5 13) stated that, as of March 31, 1993, the Government and its autonomous agencies had outstanding bonds totaling \$445.6 million. The report also stated that from 1994 through maturity, the remaining debt service requirement on those bonds, including \$423.3 million of interest, would total \$868.9 million, or about \$8,600 in bonded debt for every resident of the Virgin Islands. The report further stated that, as of August 1993, the Government and its autonomous agencies had issued an additional \$13.9 million in bonds and had been authorized or were planning to issue \$232.3 million more in bonds. The report concluded that, in general, pledged revenues should be sufficient to meet the debt service requirements of the then-outstanding bonds but that the issuance of the additional \$232.3 million in bonds could adversely affect the ability of the Government’s Internal Revenue Matching Fund, the Water and Power Authority’s water system, and the Port Authority’s aviation division to meet further debt service requirements. The report did not contain any recommendations. However, since the report was issued, the Government has been authorized by the U.S. Congress to restructure its bonded debt, allowing the issuance of additional bonds. As of September 30, 1997, the Virgin Islands Water and Power Authority was seeking an increase in its bond ceiling from \$130 million to \$220 million. Additionally, in May 1998, the Government’s Public Finance Authority issued \$541 million in bonds, the proceeds of which are to be used to refinance

\$257 million in existing Public Finance Authority bonds, pay off a \$106 million bank loan that the Government secured in January 1998 to pay a portion of outstanding income tax refunds and vendor invoices, and fund various capital improvement projects.

- The August 1993 audit report "Implementation of the Financial Management System, Government of the Virgin Islands" (No. 93-I-1 382) concluded that although the System was designed to provide an on-line environment for the Government's accounting system, improved cash management capabilities, greater control over Federal grant funds, and overall compliance with generally accepted accounting principles, the System (which was implemented by the Government in fiscal year 1989) did not produce accurate and timely financial statements and reports and did not meet generally accepted accounting principles and various Federal financial reporting requirements. This occurred because of undetected data entry errors, data transmission problems, the lack of a nontechnical user manual, insufficient user training, and the inability of the System to handle the number of users and volume of transactions. Our current review showed that the System did not provide accurate, current, reliable, and complete data with respect to Federal grants.

- The November 1985 special report "Government of the Virgin Islands 1985 Operating Deficit" (No. V-TG-VIS-30-85) stated that the fiscal year 1985 deficit was in excess of \$50 million and that proposed deficit reduction initiatives of \$46.9 million were undertaken too late in the fiscal year to have any impact on the deficit, the Government was meeting cash-flow requirements by deferring payments of payroll-related employee/employer contributions and by borrowing from other special purpose funds within the Division of Treasury (about \$4.2 million outstanding as of May 1985), the actual financial condition of the Government was unknown, and the existing financial crisis was exacerbated by financial information that was not current or accurate. The report recommended that the Governor prepare a detailed deficit reduction plan identifying specific areas of expenditure reduction and sources of revenues to resolve the deficit, request assistance from the then-Assistant Secretary for the Office of Territorial and International Affairs to establish a Federal/local task force to address financial management system problems, and require that local managers who administer Federal grant programs review the status of all current grants to ensure that those funds were used for their intended purposes.

Our current review has shown that the same types of problems continued to exist in that (1) the General Fund could end fiscal year 1998 with an operating deficit of as much as \$97 million unless additional revenue sources are found or expenditures are held to levels below those appropriated by the Legislature; (2) the level of interfund borrowing to meet cash-flow requirements has increased more than thirty-threefold (from \$4.2 million to \$14.1 million) since the issuance of the November 1985 report; and (3) the financial condition of the Government is still unknown because, as of January 31, 1998, audited financial statements had not been issued for fiscal years 1995 and 1996, although they should have been issued within 12 months of the end of each fiscal year.

FINDINGS AND RECOMMENDATIONS

A. INTERFUND LOANS AND OTHER OBLIGATIONS

We found that although the Legislature, in March 1995, authorized the Governor to borrow funds not to exceed \$15 million to meet payroll costs, the Government borrowed and recorded \$20 million based on that authorization and borrowed an additional \$120 million during the period of April 1995 to July 1997 which was not authorized by the Legislature or recorded in the Government's financial records. As of September 30, 1997, the Government had outstanding operations-related obligations (excluding bonded debt) totaling \$588 million.³ Title 33, Sections 3101 and 3108, of the Virgin Islands Code contains prohibitions against deficit spending. However, the outstanding obligations existed because the Government did not have sufficient General Fund revenues to meet all operating expenses and made it a priority to meet its biweekly payroll. In addition, the Department of Finance did not implement sound financial management practices to ensure that **interfund** loans and other obligations were recorded in the official financial records, and it did not inform the Legislature of the unrecorded interfund loans until our audit was initiated. As a result, as of September 30, 1997, the Government had a total operations-related debt of about \$588 million, or \$226 million more than the projected General Fund operating revenues of \$362 million for fiscal year 1998. In addition, because the Department of Finance borrowed \$120 million from the Special and Other Funds bank account to cover biweekly payroll costs but did not record those loans in the financial records of the Government, the balances of individual special fund accounts maintained in the Department of Finance's Financial Management System were not accurate. Moreover, there was little assurance that Federal funds were not used to pay for General Fund payroll-related expenditures because Federal and local funds were commingled in the Special and Other Funds bank account.

Interfund Loans

As of September 30, 1997, the Government had outstanding **interfund** loans totaling about \$141 million, which consisted of unauthorized and unrecorded loans of \$120 million and additional **interfund** loans of \$21 million that were legally authorized and recorded in the financial records.

³In January 1998, the Legislature approved, and the Governor signed into law, Act No. 6 197, which stated that the Virgin Islands Public Finance Authority was authorized "to borrow \$106 million from a bank or other **financial** institution and to lend the proceeds to the Government of the Virgin Islands to pay outstanding tax refunds and vendor payments." Of the \$106 million loan, \$64 million was to be used to pay income tax refunds, and \$42 million was to be used to pay vendors. Therefore, these portions of the Government's debt have, in effect, been converted from accounts payable for income tax refunds and vendor payments to loans payable for a bank loan. Based on the Act, the bank loan was to be repaid from a planned bond refinancing. The issuance of the new bonds was concluded in May 1998. However, if the bank loan is not retired with bond proceeds within 10 months, a \$41.2 million principal payment will be due immediately and the remaining \$64.8 million principal balance would have to be repaid over a period of 5 years from the Internal Revenue Matching Fund. In addition, interest on the loan would increase **from** 6.9 percent to 10 percent a year.

Unauthorized Interfund Loans. We found that because the Government was unable to meet its biweekly payroll and payroll-related expenses, the Department of Finance established the practice of borrowing but not recording in its financial records amounts from the Special and Other Funds bank account to cover the payroll-related expenses for FICA taxes and health insurance premiums. Department of Finance officials told us that although the practice of making **interfund** loans to meet payroll-related expenses had been occurring for a number of years, during the past 3 fiscal years the Department was unable to reimburse the Special and Other Funds bank account before the end of each fiscal year because of a decline in General Fund revenues.⁴ As of September 30, 1997, the Payroll Fund owed the Special and Other Funds bank account a total of \$120 million. There was no legislative authorization to borrow this money, and these “unauthorized loans” had not been recorded against individual special fund accounts. Accordingly, the balances maintained by the Department of Finance’s Financial Management System for the General Fund and special fund accounts were not accurate. Specifically, the financial records for the General Fund should include a Due to Other Funds liability account for the \$120 million in loans, and the financial records for each special fund should include a Due From Other Funds asset account for its appropriate share of the \$120 million in loans.

According to the Department of Finance’s Accounting Manual, the Payroll Fund was established so that “payroll costs chargeable to various funds may be segregated and consolidated.” Furthermore, Department of Finance officials told us that the Payroll Fund operated as a zero balance fund, or “wash account.” Therefore, according to Department of Finance officials, amounts should have been transferred to the Payroll Fund bank account from the General Fund bank account on a biweekly basis to cover the payroll and payroll-related expenses. However, because of an insufficient balance in the General Fund bank account, the Government used the Special and Other Funds bank account to pay for the payroll-related expenses. In order for the Payroll Fund to operate as a zero balance fund, the Department of Finance prepared checks from the Payroll Fund bank account to reimburse the Special and Other Funds bank account for amounts borrowed. These checks were held by the Department of Finance’s cashier awaiting authorization from Division of Treasury officials to deposit the checks into the Special and Other Funds bank account when there were sufficient General Fund revenues to cover the checks. Accordingly, as of September 30, 1997, the Department of Finance’s cashier held, at the Department’s offices on St. Thomas, 87 checks, totaling \$120 million, that were written against the Payroll Fund bank account for expenses related to pay periods from April 24, 1995, through July 31, 1997. The checks were made payable to either the FICA Taxes Withheld Fund (\$9.1 million) or the Health Insurance Fund (\$29 million). (Both funds are part of the Special and Other Funds bank account.) Based on our review of the financial information contained in the Department of Finance’s Financial Management System for the FICA Taxes Withheld Fund and the Health Insurance Fund for fiscal years 1995 through 1997, we found that the two funds had a combined deficit of about \$130 million for fiscal years 1995 through 1997. (The

⁴Based on our November 1985 report on the Government’s fiscal year 1985 operating deficit (see Prior Audit Coverage section of this report), we concluded that the practice of making **interfund** loans to pay payroll-related expenses was used as early as fiscal year 1985.

\$10 million difference could be accounted for by other interfund transactions and transactions in transit that should be reconciled during the year-end process when the financial statements for these fiscal years are prepared.)

According to Title 3, Chapter 11, of the Virgin Islands Code, the Department of Finance is responsible for providing “general supervision over, and custody of, the special and public trust funds.” Furthermore, according to the Department of Finance’s Accounting Manual, the “Special Fund” group consists of about 400 funds “created to account for certain types of revenues specifically earmarked for certain activities of the Government, and also for grants and/or contributions to finance certain special programs sponsored by the Insular Government or jointly with the Federal Government.” In addition to most Federally funded programs, many locally funded programs are accounted for through the Special and Other Funds bank account, including the Internal Revenue Matching Fund (pledged for debt service on most Government bonds), the Health Revolving Fund (used to finance hospital operations), the Tourism Advertising Revolving Fund (used to promote the tourism industry), the Transportation Trust Fund (used to finance highway construction and repairs), and the Paternity and Child Support Revolving Fund (used to receive and distribute child support payments). Therefore, the Special and Other Funds bank account contained both local and Federal funds. According to the Accounting Manual, “The use of the revenues and receipts credited to these [special] funds are restricted to the purposes determined by the provisions of the legislation or directives creating them, and expenditures and obligations against these funds shall be made only in accordance with such provisions.”

We reviewed the activity in the Special and Other Funds bank account and found that the Department of Finance maintained three accounts, one savings account and two checking accounts, at Banco Popular de Puerto Rico’s St. Thomas branch. One of the checking accounts was referred to as the “old” account, and the other was referred to as the “new” account. According to the Department of Finance’s Acting Director of Treasury, the savings account contained only local funds not immediately earmarked for expenditure, such as proceeds from the Internal Revenue Matching Fund. As of September 30, 1997, the savings account had a balance of \$23 million. With respect to the checking accounts, we found that electronic transfers of Federal funds were credited to either the “old” or the “new” checking account but that checks could be written only against the “new” account. Therefore, electronic transfers of Federal funds received into the “old” account were transferred to the “new” account by means of debit and credit memoranda. In addition, daily local collections were deposited into the “new” account.

For purposes of our review, we concentrated our audit efforts on the “new” checking account and found that the account was overdrawn on 143 days during fiscal years 1996 and 1997, including by \$12 million on December 4, 1995. We also found that the bank started to charge the Government for overdrafts in November 1996 and that, through September 30, 1997, such charges totaled about \$12,150.

We also analyzed the electronic transfers of Federal grant funds received by the “new” checking account during fiscal years 1996 and 1997 and found 182 unidentified electronic

transfers of Federal funds, totaling \$25 million, for which a Statement of Remittance⁵ had not been prepared. Accordingly, these 182 transactions were not recorded in the Financial Management System and credited to the appropriate special fund accounts.

During legislative hearings on April 7, 1998, the Commissioner of Finance stated that he “categorically denie[d]” that Federal and local funds “were commingled” with respect to the \$120 million in unauthorized **interfund** loans. However, we found 76 instances in which the Special and Other Funds bank account was overdrawn on days when Federal funds (157 electronic transfers, totaling \$18.8 million) were received and should have been available in the account. For example, on October 10, 1996, the Department of Education requested and received an electronic transfer of Federal funds to pay for educational supplies totaling \$479,000. The Department of Finance processed a check on October 11, 1996, to pay for the educational supplies, but the check was not released to the vendor until October 15, 1996. We found that the Special and Other Funds checking account was overdrawn during the 4 business days between October 10 and 15, 1996, although the October 10, 1996, electronic fund transfer of \$479,000 should have been available in the bank account at least until October 15, 1996, the date that the check was released by the Department of Finance. Therefore, we concluded that the electronic transfer of Federal funds earmarked for educational supplies for the Department of Education was used to fund the overdrawn status of the checking account during the period of October 10 to 15, 1996.

We believe that this example and the 75 other instances in which the Special and Other Funds bank account was overdrawn on days when Federal funds were received support our conclusion that Federal funds were used to cover the overdrawn condition of the Special and Other Funds bank account, which would not have occurred if the \$120 million in unauthorized and unrecorded **interfund** loans had not been made. As a result, the unauthorized loans restricted the amount of funds available for the payment of expenses of Federal programs funded through special fund accounts.

In our opinion, the unrecorded loans of \$120 million from the Special and Other Funds bank account were not authorized by the Legislature and were therefore improper. In addition, the unauthorized loans may be in violation of Title 33, Section 3 101, of the Virgin Islands Code, which states:

No officer or employee of the Virgin Islands shall make or authorize an expenditure from, or create or authorize an obligation under, any appropriation or fund in excess of the amount available therein; nor shall any such officer or employee involve the government in any contract or obligation for the payment of money for any purpose, in advance of

⁵A Statement of Remittance is the document used to record revenue information into the Financial Management System. According to the Department of Finance’s Accounting Manual, agencies that do not have a collector or assistant collector “shall prepare a Statement of Remittance, to cover any remittances, and transmit it, together with the remittances, to the collector of the Department of Finance.”

appropriations made for such purpose, unless such contract or obligation is authorized by law. [Emphasis added.]

Further, the Government's failure to record these loans in its financial records as liabilities of the General Fund and receivables of the special funds was contrary to generally accepted accounting principles. Specifically, Section 1100.10 1 of the Codification of the Government Accounting and Financial Reporting Standards states:

A government accounting system must make it possible both: (a) to present fairly and with full disclosure the financial position and results of financial operations of the funds and account groups of the governmental unit in conformity with generally accepted accounting principles and (b) to determine and demonstrate compliance with finance-related legal and contractual provisions.

In addition to the requirements imposed by laws, regulations, contractual obligations, and generally accepted accounting principles, the Government, in our opinion, has a trust responsibility to the residents of the Virgin Islands to accurately record and report on all of its financial activities. This responsibility includes recording in the financial records of the respective funds all known outstanding obligations, including the obligations discussed in this report.

Authorized Interfund Loans. We also found that, as of September 30, 1997, certain special funds were owed about \$21 million for authorized **interfund** loans, which consisted of \$11.5 million that was still outstanding on the loans of \$20 million⁶ made in accordance with Act No. 6068 (see Background section of this report) and an additional \$9.6 million borrowed by the Government in 1996. Regarding the \$9.6 million in loans, the Government, in March 1996, borrowed \$3.1 million from the AMPAC (American Property and Casualty Insurance Company) Settlement bank account, which was established with funds from the settlement of a case against an insurance company that defaulted on policyholder claims after Hurricane Hugo in 1989. The \$3.1 million was used as an allotment to the University of the Virgin Islands for operating expenses. Additionally, in August 1996, the Government borrowed \$6.5 million from the St. John Capital Improvement Fund for General Fund expenses. These two loans were outstanding as of September 30, 1997. All of these loans were recorded in the financial records of the related funds.

Other Outstanding Obligations

In addition to the **interfund** loans totaling \$141 million, we found that, as of September 30, 1997, the Government had other outstanding obligations totaling \$447 million as follows:

⁶Department of Finance officials stated that although a total amount of \$20 million was borrowed in accordance with Act No. 6068, the outstanding amount at any time never exceeded the \$15 million limit contained in the Act.

- FEMA was owed about \$150 million⁷ for Community Disaster Loans provided to the Government. Specifically, in May 1996, FEMA denied the Government's request to convert the \$44.3 million outstanding balance (including interest) of the 1989 Hurricane Hugo loan to a grant. In addition, the Government had not requested that FEMA convert the \$96.5 million outstanding balance (including interest) of the 1995 Hurricane Marilyn loan to a grant. The Government also owed FEMA \$9.5 million (including interest) on a State-Share Loan that was provided to allow the Government to meet the state matching requirement for FEMA disaster assistance funds.

- Governmental employees were owed \$141 million* for the estimated cost of salary increases and related fringe benefits based on union negotiations (concluded and pending) for fiscal years 1992 through 1997.

- Taxpayers were owed \$76 million⁸ for income tax refunds for tax years 1994 through 1996, which consisted of \$23 million for tax years 1994 and prior years, \$26 million for tax year 1995, and \$27 million for tax year 1996.

- Vendors were owed at least \$67 million,¹⁰ which consisted of \$61 million for miscellaneous disbursement vouchers and purchase orders (for about 4,000 vendors) processed but not paid by the Department of Finance during March to September 1997, \$4 million for about 1,000 vendor payments for which checks had been prepared but insufficient funds precluded the checks from being issued to the vendors, and \$2 million for about 1,000 vouchers that had been rejected by the accounts payable system because of data

⁷FEMA released an additional \$12 million in Community Disaster Loan funds to the Government prior to January 31, 1998, and an additional \$12 million during February 1998. Therefore, the total amount owed FEMA as of February 1998 was at least \$174 million, not including additional interest accrued during the period of October 1997 through February 1998.

⁸Legislative hearings were held on December 2, 1997, to identify funding sources for a union contract for 3,200 Governmental employees, which the Governor had signed and submitted to the Legislature for approval. During the hearings, Governmental financial managers testified that the contract included salary increases totaling \$13 million but that, in exchange for these increases, the union agreed to forego \$45 million in retroactive salary increases due for fiscal years 1993 through 1996. Therefore, as of January 31, 1998, total obligations for retroactive salary increases had decreased from \$141 million to \$109 million.

⁹In January 1998, the Legislature approved, and the Governor signed into law, authorization for the Government to borrow \$106 million to pay outstanding income tax refunds and vendor payments. In addition, as of January 1998, the amount owed for income tax refunds had increased to about \$90 million. Because \$64 million of the \$106 million borrowed was to be used for payment of outstanding income tax refunds, the obligation for income tax refunds as of January 31, 1998, was reduced to \$26 million, with \$64 million converted to a loan payable.

¹⁰Because \$42 million of the \$106 million loan approved by the Legislature in January 1998 was to be used for vendor payments, the obligation for vendor payments as of January 31, 1998, was reduced to \$25 million, with \$42 million converted to a loan payable. However, because these amounts did not include additional vendor invoices that may have been held by operating agencies and not processed for payment, the total amount owed vendors may actually be more than \$25 million as of January 31, 1998.

entry errors or insufficient data (these vouchers were pending completion of processing). Of the \$61 million for miscellaneous disbursement vouchers and purchase orders that were processed but not paid, \$12 million represented amounts owed by the General Fund to 16 of the Government's special funds.

- The Government Employees Retirement System was owed \$13 million, which consisted of \$7 million for unfunded portions of the Early Retirement Incentive, Training and Promotion Act of 1994 and \$6 million for Government contributions and loan payments to the Retirement System for the two pay periods in September 1997.

A summary of outstanding obligations as of September 30, 1997, and the estimated obligations as of January 31, 1998, is presented in Appendix 2. Although total obligations decreased by \$6 million during the intervening 4 months, the \$106 million bank loan that was approved in January 1998 only postponed the payment of \$106 million in obligations to future periods, with an additional obligation to pay interest on the \$106 million loan.

Response to Advisory Report

On November 21, 1997, we requested that the Government respond, by December 3, 1997, to the draft advisory report on the status of **interfund** loans and other obligations (see Prior Audit Coverage section of this report). The **draft** advisory report further stated that the Government's comments had to be submitted by that date to ensure that they would be included in the final version of the report. However, we did not receive the response from the Governor, dated December 1, 1997, and postmarked December 29, 1997, until January 6, 1998. Therefore, the Governor's comments were not included in the final version of the advisory report.

Governor's Response. In response to the draft advisory report, the Governor's response (see Appendix 3) expressed "strong objection" to the conclusions of the report and stated that the Administration did not make \$120 million in unauthorized **interfund** loans during the period of April 1995 to September 30, 1997. The response stated that "our records for that same period show that over \$41 million was already borrowed before April 1, 1995" and "the fact is that this total represents amounts borrowed that remain unpaid, and the amounts legally authorized to be transferred from other funds to support operating expenses of the General Fund." The response also stated that "at the start of Fiscal Year 1995, October 1, 1994, the General Fund owed \$34.5 million to the Payroll Fund for further disbursement to the FICA and the Health Insurance Funds."

In addition, the response stated, "During Fiscal Years 1995 through 1997, legislation was enacted authorizing borrowings and transfers of \$49.9 million to support the operating expenses of the General Fund, which includes payroll." The five legislative acts referred to in the response as authorizing a total of \$49.9 million in **interfund** borrowing and transfers were Act Nos. 6075, 6078, 6084, 6086, and 6119. Finally, the response "seriously" questioned the "figure of \$574 million [as stated in the draft advisory report] as the 'general operating obligations' of the Government." The response stated, "Only the current portion

of the long-term debt is considered for accounting purposes, as general operating obligations.”

Office of Inspector General Reply. We replied to the Governor’s response to the draft advisory report in a letter dated February 5, 1998 (see Appendix 4). In the letter, we stated that “our review of the 87 checks showed that, although they were dated from September 9, 1995, through September 12, 1997, the checks were for repayment of FICA and health insurance expenses related to the pay periods April 1 1-24, 1995, through July 18-3 1, 1997.” Our reply also stated, “If, as stated in [the Governor’s] response, ‘over \$4 1 million was already borrowed before April, 1995,’ then that \$4 1 million was in addition to, not a part of, the \$120 million discussed in our report.” Our reply further noted that the Governor’s statement that “at the start of Fiscal Year 1995, October 1, 1994, the General Fund owed \$34.5 million to the Payroll Fund for further disbursement to the FICA and the Health Insurance Funds” raises concerns about the accuracy of the General Purpose Financial Statements included in the single audit report for the fiscal year ended September 30, 1994, because the financial statements and the accompanying notes did not include reference to an amount of \$34.5 million that the General Fund owed to the Payroll Fund as of September 30, 1994 (which would have been carried forward to beginning balances on October 1, 1995).

In regard to the five legislative acts, with appropriations totaling \$49.9 million, referred to in the Governor’s response to the advisory report, our reply described in detail the reasons for our conclusion that those legislative acts did not authorize loans of the type included in the \$120 million in unauthorized **interfund** loans reported in the advisory report (and in this report). We indicated that the only exception we were inclined to make was that Act No. 6078 authorized the transfer of \$6 million **from** “any funds available in the Treasury of the Government of the Virgin Islands to offset the decrease in revenue” that occurred as a result of an authorized rollback in 1994 real property taxes to the 1992 rate of assessment. However, we stated that we would offset this \$6 million against the reported \$120 million in unauthorized **interfund** loans only when the transfer was recorded in the official financial records of the Government.

Finally, we did not identify the \$570 million (as reported in the final advisory report but adjusted to \$588 million in this report) as “general operating obligations” but as a “total operating debt,” with the intention of differentiating it from bonded debt, which is generally incurred for the purpose of funding capital improvement projects. All of the items included in the \$570 million amount were incurred either as a result of the Government’s general operations or to finance general operating expenses. However, to more clearly identify the nature of the obligations that were the subject of our review, we have referred to these debts as “operations-related obligations” in this report.

Response to Preliminary Draft Report

In the June 22, 1998, response (Appendix 5) to the preliminary draft of this report from the Commissioner of Finance, the response stated that Title 23, Section 1125, of the Virgin Islands Code authorized the Governor “to utilize all available resources of the Territory while

under a State of an Emergency.” However, because that authorization is contained in a section of the Virgin Islands Code (titled the “Virgin Islands Territorial Emergency Management Act”) that pertains specifically to the proclamation of a state of emergency to “activate the disaster preparation, response and recovery aspects of the territorial and interjurisdictional emergency and major disaster plans,” we do not believe it was applicable to the use of “all available resources” to meet regular payroll-related expenses. In addition, the unrecorded **interfund** loans of \$120 million were made during the period of April 1995 (5 months before Hurricane Marilyn) through July 1997 (22 months after Hurricane Marilyn). Therefore, the entire amount would not have been related to the state of emergency that existed after the hurricane. Further, the Government received FEMA Community Disaster Loans totaling \$50 million after Hurricane Hugo (September 1989) and \$127 million after Hurricane Marilyn (September 1995) to compensate the Government for the decline in revenues that occurred during the 3 years immediately following each hurricane. One of the primary uses of the disaster loan funds was to meet payroll expenses during the hurricane recovery period. Therefore, any additional borrowing by the Government to meet General Fund payroll expenses during the **3-year period after** Hurricane Marilyn would not, in our opinion, have come under the “state of emergency” provisions of Title 23, Section 1125, of the Virgin Islands Code.

The response also “vehemently” objected to our conclusion that Federal funds were used to cover the overdrawn condition of the Special and Other Funds bank account, stating that we “neglected to review the group of bank accounts that provide funding for Special and Other Funds obligations.” However, our report (page 8) states that we found that there were only three bank accounts related to Special and Other Funds activities: (1) a savings account that, according to the Acting Director of Treasury, contained only local **funds** (including Internal Revenue Matching Fund monies) that were not immediately earmarked for expenditures; (2) an “old” checking account that was inactive except for occasional electronic transfers of Federal funds that were subsequently transferred to a “new” checking account; and (3) the “new” checking account, which was the active account used for regular receipts and disbursements pertaining to Special and Other Funds. Regardless of the existence of the savings account and the “old” checking account, we believe that the examples cited in the report in which the “new” checking account was overdrawn on days when electronic fund transfers of Federal funds were received clearly indicate that those Federal funds were not immediately available for expenditure because of the overdrawn condition of the “new” checking account.

Finally, the response stated that “the Department has always maintained that cash **from** the local portion of the Special and Other Funds group of bank accounts has been supplementing the Federal portion.” Specifically, the response stated that the Department’s review of Federal accounts related to the Department of Public Works shows that during the period of October 1, 1995, through July 31, 1997, disbursements of Federal funds exceeded Federal receipts. While we agree that some Federal programs of the Department of Public Works operate on a reimbursable basis and therefore require the initial use of local funds, such reimbursable funding is the exception. Based on our limited review of the grant accounting practices of the Departments of Health, Human Services, Education, and Public Works (see

Finding B), we found that these agencies generally operated on an “advance” funding basis and that, in particular, the Departments of Health and Human Services requested drawdowns of Federal funds in advance of the payment of expenditures related to their Federal programs.

Despite the cited disagreements with our audit conclusions, the response to the preliminary draft report stated that the Department of Finance (1) was in the process of recording all **interfund** borrowings and transfers from the Special and Other Funds account to the General Fund account, (2) was in the process of establishing a separate bank account for all Federally funded programs, (3) had issued policy memoranda to departments and agencies to request that they provide the Department with sufficient information to identify the source of Federal electronic fund transfers, (4) had contacted U.S. Treasury officials to determine whether any interest liability exists with regard to Federal funds drawn down in advance of need (see Finding B), and (5) will assess current and future financial accounting and reporting needs of the Government (see Finding C).

Recommendations

We recommend that the Governor of the Virgin Islands:

1. Require the Department of Finance to record in the Financial Management System the \$120 million borrowed by the General Fund from the Special and Other Funds bank account to pay FICA taxes and health insurance premiums for pay periods during April 1995 to July 1997. Specifically, the Department should process journal entry transactions to establish a Due to Other Funds liability account in the General Fund in the amount of \$120 million and a Due From Other Funds receivables account in each of the special funds from which monies were borrowed for each fund’s appropriate share of the \$120 million inter-fund loan. In addition, the Department of Finance should provide a report to the Legislature explaining the uses made of the amounts borrowed without legislative authorization and the status of repayment so that informed decisions on the Government’s finances can be made as they pertain to the fund accounts affected by this unauthorized interfund debt.

2. Require the Department of Finance and the Office of Management and Budget to develop and submit for legislative approval a plan of action to liquidate the \$120 million unauthorized **interfund** debt. The plan of action should ensure that any Federal funds included in the borrowed amounts are given first priority for repayment in full; any special funds that were subject to legislative, contractual, or other legally binding restrictions as to use are given second priority for repayment in full; and any special funds that were subject to administrative restrictions as to use are given third priority for repayment in full. Further, if the plan of action proposes that amounts borrowed from unrestricted funds not be repaid, the Department of Finance should obtain retroactive approval from the Legislature for the transfer of such amounts.

3. Require the Department of Finance to repay the \$11.5 million outstanding balance of amounts borrowed from special funds in accordance with Act No. 6068. Specifically, the

Department should set aside the necessary General Fund revenues, process the appropriate bank transaction to transfer the funds from the General Fund to the special funds from which the amounts were originally borrowed, and process journal entry transactions to record the repayment in the Financial Management System. In addition, the Department of Finance should provide a report to the Legislature explaining the uses made of the amounts borrowed in accordance with Act No. 6068 and the status of repayment so that informed decisions on the Government's finances can be made as they pertain to the fund accounts affected by this authorized interfund debt.

4. Require the Department of Finance to establish a separate bank account at a suitable local banking institution to segregate and separately account for all Federal funds received and all expenditures of Federal funds made by the Government. In addition, the Department of Finance should transfer to the new bank account all amounts currently maintained in the Special and Other Funds bank accounts that were from Federal sources. Further, the Department should amend all **drawdown** agreements with Federal grantor agencies to ensure that future drawdowns, whether made by electronic fund transfers or by any other means, are deposited into the new bank account.

5. Require the Department of Finance to consolidate the "old" and "new" Special and Other Funds checking accounts maintained at **Banco Popular de Puerto Rico's** St. Thomas branch.

6. Require the Department of Finance to analyze any unidentified electronic fund transfers of Federal funds in the two existing Special and Other Funds bank accounts to identify the source and appropriate fund account to which each transfer should be recorded and process journal entry transactions to record such electronic fund transfers in the Financial Management System.

7. Require the Department of Finance to transfer \$6 million from any "available" special funds to the General Fund in accordance with Act No. 6078 and to process journal entries to record the transfer in the Financial Management System. In addition, the Department of Finance should provide a report to the Legislature explaining the uses made of the amounts transferred in accordance with Act No. 6078 so that informed decisions on the Government's finances can be made as they pertain to the fund accounts affected by this authorized **interfund** transfer.

8. Establish, jointly with the Legislature and with participation by private sector representatives, a special task force to address and develop a plan of action to liquidate the Government's \$588 million (as of September 30, 1997) outstanding operations-related obligations.

Governor of the Virgin Islands Response and Office of Inspector General Reply

On June 30, 1998, we transmitted a draft of this report to the Governor of the Virgin Islands requesting a response by August 7, 1998. On August 20, 1998, we received a response (Appendix 5), dated August 7, 1998, from the Governor of the Virgin Islands. The response concurred with Recommendations 1, 3, 4, 5, 6, 7, and 8 and did not concur with Recommendation 2. Based on the response, we consider Recommendations 4 and 5 resolved and implemented and Recommendation 2 unresolved and request additional information for Recommendations 1, 3, 6, 7, and 8 (see Appendix 6).

Recommendation 2. Nonconcurrence.

Governor of the Virgin Islands Response. The response stated that "[t]he amount utilized by the General Fund from Special and Other Funds to pay General Fund obligations was well within our legal authorization, and that the Department [of Finance] did not illegally borrow \$120 million from Special and Other Funds."

Office of Inspector General Reply. As discussed in greater detail in the following paragraphs, we do not believe that the various laws cited by the Governor and the Commissioner of Finance in responses to prior versions of this report granted authorization for the \$120 million in loans from the Special and Other Funds. Because the response did not indicate that any actions would be taken to repay the borrowed amounts, we consider the recommendation unresolved.

General Comments on Finding

The Governor's August 7, 1998, response provided additional comments. The Governor's comments and our reply are as follows:

Governor of the Virgin Islands Response. In his response, the Governor essentially reiterated disagreement, as stated in the June 22, 1998, response from the Commissioner of Finance to the preliminary draft report (pages 13-15), with our conclusions that the unrecorded interfund loans totaling \$120 million were not legally authorized and that at least a portion of the \$120 million of loans may have involved Federal funds. The response again cited Title 23, Section 1125, of the Virgin Islands Code and several legislative acts as evidence that authorization for the interfund loans was provided by law. Additionally, the response cited a review conducted by the Department of Finance of Federal grant drawdowns and expenditures related to the Department of Public Works as evidence that, contrary to our conclusion, local funds were used to supplement Federal grants. Further, the response stated that although a total amount of \$20 million was borrowed in accordance with Act No. 6068, the outstanding amount at any time never exceeded the \$15 million limit stated in the Act.

Office of Inspector General Reply. As discussed in reply to the Commissioner of Finance's June 22, 1998, response to the preliminary draft report (pages 13-15 of the report), it is our opinion, based on our review of the legislation cited by the Governor and the Commissioner, and our discussions with officials of the Legislature of the Virgin Islands, that the unrecorded **interfund** loans totaling \$120 million were outside the scope and intent of the cited legislation. Additionally, we have noted that, although some of the Federal grant programs administered by the Department of Public Works operate on a cost-reimbursement basis, such reimbursement funding is the exception. Based on our limited review of grant accounting practices at the Departments of Health, Human Services, Education, and Public Works (see Finding B), we found that these agencies generally operated on an advance funding basis and that, in particular, the Departments of Health and Human Services requested drawdowns of Federal funds in advance of the payment of expenditures related to their Federal programs. Based on our analysis of the timing and availability of Federal fund drawdowns, we continue to believe that, because of the unrecorded interfund loans of \$120 million, Federal funds were not always available for grant program expenses on the dates on which the drawdowns were made. However, because of the potentially significant effect of this issue, we have decided to perform comprehensive audits of several major Federally funded programs during fiscal year 1999. We believe that these audits should provide a clearer understanding of the effect that inter-fund loans may have on Federally funded programs within the Government of the Virgin Islands. With regard to the statement that the outstanding balance of loans made in accordance with Act No. 6068 never exceeded the \$15 million limit stated in the Act, we have added footnote 1 (page 2 of the report) to clarify this issue.

B. FEDERAL GRANT BALANCES

We found that (1) the tracking system for Federal grants maintained by the Virgin Islands Office of Management and Budget and the Financial Management System maintained by the Department of Finance did not accurately reflect the unobligated balances of Federal grants and (2) Federal grants awarded to the Government of the Virgin Islands were not always administered efficiently and effectively. The Code of Federal Regulations contains criteria applicable to the Cash Management Improvement Act and the liquidation of obligations, and circulars issued by the U.S. Office of Management and Budget contain policies, regulations, and guidance related to the management of Federal grant programs. These requirements were not always complied with because (1) the Virgin Islands Office of Management and Budget did not have sufficient personnel to effectively administer all of the Federal grants awarded to the Territory; (2) the Department of Finance did not receive the information needed to prepare Statements of Remittance for all electronic transfers of Federal funds and record, in a timely manner, the receipt of Federal funds in its Financial Management System; and (3) the Department of Education's internal "cumbersome procurement process" impeded the negotiation of contracts for goods and services and expenditure of grant funds in a timely manner. As a result of these deficiencies, (1) the Virgin Islands Office of Management and Budget had to rely on Government agencies to provide it with information relative to the Government's approximately 400 Federal grant awards, totaling \$427 million; (2) there were at least 76 instances in which Federal grant funds, totaling \$18.8 million, were not immediately available for their intended purposes; (3) the Department of Public Works had not used Federal grants of \$38.1 million that were received for the establishment and operation of the public bus transportation system (\$6.6 million), the purchase of buses for elderly and handicapped persons (\$0.8 million), various environmental protection projects (\$17 million), and various highway improvement and construction projects (\$13.7 million); and (4) the Department of Education, as of January 31, 1998, had not submitted the required annual Financial Status Report pertaining to its \$17 million block grant for the fiscal year ending September 30, 1997.

Office of Management and Budget

The Office of Management and Budget's Federal Grants Management Unit maintained information on approximately 400 Federal grants, totaling \$427 million. However, because the Unit's staffing was reduced from four to two grant analysts during the period of October 1, 1996, to January 31, 1998, the Unit relied on unaudited information from grantee agencies as the primary source of information for its Federal grants tracking system. In addition, the Unit maintained copies of grant award documents only for 3 years and did not maintain copies of electronic transfers of Federal funds (except for grants administered by the Office of Management and Budget, such as Department of the Interior grants for health care facilities construction and Federal Emergency Management Agency grants for disaster assistance). We found that, because of an insufficient number of staff to corroborate and analyze Federal grant information received from grantee agencies, there was little assurance that the grant balances compiled by the Unit were accurate or represented amounts that were available for expenditure. For example, grant amounts in the tracking system (1) did not take

into consideration grant funds that had been obligated but not expended; (2) were not deleted when the grant periods had expired, although the remaining grant balance should have reverted to the Federal grantor agencies, since the grant funds were not spent and extensions to use the funds had not been requested from the grantor agency; and (3) did not take into consideration grant funds that could not be used because a required local match had not been identified or appropriated for expenditure.

Although the objective of our audit was to determine the unobligated balances of Federal grant accounts, with the anticipation of identifying unused Federal grant funds that could be reprogrammed for other approved purposes, we were unable to obtain this information from a single, central source within the Government. Accordingly, we expanded our review to include limited testing of transactions at the Departments of Health, Human Services, Education, and Public Works (the four agencies that received the most Federal funds on an annual basis) to corroborate account balances for Federal grants. Because we were unable to obtain specific information from the Office of Management and Budget with respect to Federal grant account balances, we believe that the Office should require all Government agencies to routinely provide the Federal Grants Management Unit with copies of all applications for Federal grants, all Federal grant awards, and all electronic transfers of Federal funds. In addition, we believe that the Federal Grants Management Unit should be provided with a sufficient number of staff and other resources needed for the Unit to develop and implement a more comprehensive and up-to-date grants management system.

Department of Finance

The Department of Finance was responsible for preparing Statements of Remittance for electronic transfers of Federal funds from the U.S. Treasury and for recording Statements of Remittance and expenditure information in the Financial Management System. We found that the Department of Finance had made significant improvements in recording expenditure information but that additional improvements were needed in recording the receipt of Federal funds. Specifically, in accordance with its internal procedures, the Department of Finance prepared a Statement of Remittance for electronic transfers of Federal funds only when the grantee agency provided fund transfer information to the Department. However, some agencies did not provide the Department with the necessary information. Therefore, Statements of Remittance could not be prepared by the Department for all electronic transfers of Federal funds, and, because the Statement of Remittance was the document used to record the fund information into the Financial Management System, there was little assurance that all Federal funds received through electronic transfer were recorded. As discussed in Finding A, we found that 182 electronic fund transfers, totaling \$25 million, had not been identified and recorded to the appropriate accounts for Federal grant drawdowns made during fiscal years 1996 and 1997. Therefore, individual Federal grant accounts in the Financial Management System did not contain accurate, current, complete, and reliable information. This deficiency occurred, at least in part, because the Department of Finance's Accounting Manual did not contain specific regulations regarding the processing of electronic transfers of Federal grant funds.

To remedy the lack and/or untimeliness of recording electronic transfers of Federal funds in the Financial Management System, the Department of Finance, in March 1997, hired an individual to specifically review and identify the sources of electronic transfers of Federal funds that were received by the bank but were not recorded in the Financial Management System and to prepare Statements of Remittance to record the transfers in the Financial Management System. However, we found that the individual was not given a complete listing of all unidentified electronic transfers of Federal funds and that, as of January 31, 1998, the recording of Statements of Remittance for all Government deposits had been completed only through May 1997. As detailed in Finding A, we also found 76 instances in which Federal funds (157 electronic transfers, totaling \$18.8 million) were not available for approved purposes because the Special and Other Funds bank account was overdrawn on the days when those funds were received.

Further, the Department of Finance did not comply with the Cash Management Improvement Act (31 CFR 205), which states that “a state and a federal agency shall minimize the time elapsing between the transfer of funds from the United States Treasury and the pay out of funds for program purposes by a state, whether the transfer occurs before or after the pay out” and that “a state will incur an interest liability to the federal government from the day federal funds are credited to a state account to the day the state pays out the funds for programs purposes.” Specifically, we found that checks processed by the Department of Finance for payments to vendors under Federal grant programs administered by the Department of Education took as long as 200 days between the receipt of an electronic transfer of Federal funds and the release of the check to the vendor. For example, on February 4, 1997, the Department of Education requested and received an electronic transfer of Federal funds to pay for operating supplies and travel-related expenditures totaling \$115,000, of which \$74,000 was for St. Thomas invoices. During the period of February 4 to July 17, 1997, the Department of Finance processed checks to pay for the expenditures, but the checks were not released until various dates during the period of February 14 through August 22, 1997, with at least one check being issued up to 200 days after the electronic transfer of Federal funds was received. In addition, the Department of Finance did not recognize a liability for interest owed the Federal Government for the days that the Federal funds were on deposit in the Government of the Virgin Islands bank account but not used. Therefore, the Department of Finance did not comply with the requirements of the Cash Management Improvement Act with respect to the timely release of Federal funds and the recognition of an interest liability to the Federal Government.

Based on the results of our review, we believe that the Department of Finance should be required to timely identify all electronic transfers of Federal funds (see Recommendation A.6) and to record this information in the Government’s Financial Management System in a timely manner. In addition, we believe that the Department of Finance’s Treasury Division, in compliance with the Cash Management Improvement Act, should be required to compute the interest liability for electronic transfers of Federal funds not immediately released for payment and to remit those amounts to the U.S. Treasury. We also believe that the Department of Finance should be required to establish a separate

checking account to be used exclusively for the receipt and disbursement of Federal funds (see Recommendation A.4).

Departments of Health and Human Services

The Federal Grant Manager was the official in the Department of Health with primary responsibility for the financial administration of Federal grants, totaling about \$14 million annually, for the Women, Infants and Children (WIC) Supplemental Food Program; the Medical Assistance Program; and various health-related block grants and categorical grants, such as those related to mental health and drug abuse treatment programs.

The Deputy Commissioner of Fiscal Services was the official in the Department of Human Services with primary responsibility for the financial administration of Federal grants totaling about \$18 million annually for the Child Care block grant, the Food Stamp Program, the Headstart Program, and a human services-related block grant.

We found that the Departments of Health and Human Services maintained adequate financial oversight of their Federal grants, generally submitted required financial reports in a timely manner, and provided the Office of Management and Budget with requested information pertaining to Federal grants. Our review also disclosed that these departments did not have any significant unobligated balances of Federal grant funds that could be reprogrammed for other approved purposes.

Department of Public Works

Federal grants awarded to the Government of the Virgin Islands by the U.S. Department of Transportation's Federal Transit Administration and Federal Highway Administration and the U.S. Environmental Protection Agency were administered by the Transportation Office, the Federal-Aid Highway Program Office, and the Environmental Services Division, all of which are in the Department of Public Works.

Federal Transit Administration Grants. During the period of 1984 to 1997, the Transportation Office received 22 Federal grants, totaling \$17 million, primarily to provide public bus transportation for Virgin Islands residents and bus service for elderly and handicapped persons. The Transportation Office contracted with a private company to provide public bus transportation in the Virgin Islands and contracted for the purchase of specialized buses so that local nonprofit organizations could provide bus services to elderly and handicapped persons.

We found that the Transportation Office did not maintain pertinent documents for the effective oversight of the Federal Transportation Administration grants, including grant award documents, expenditure documents, documents to verify the electronic transfer of Federal funds, and financial status reports. The most recent financial status report, which we obtained from the grantor agency, was for the period ending December 31, 1991. In addition, the Transportation Office was unable to access the computerized database

maintained by its grantor agency because of computer problems. Accordingly, we contacted the grantor agency and obtained information that was in its Grants Management Information System as of January 8, 1998. Because of this lack of oversight and the Government's inability to negotiate additional contracts with suppliers of buses, these available Federal funds were not used in an efficient and effective manner to expand and improve the level of transportation services.

For example, during the period of April 1984 to March 1997, the Transportation Office was awarded 11 Federal grants, totaling \$12.9 million, from the Federal Transit Administration to provide bus service in the Territory. However, as of January 31, 1998, the Federal Transit Administration's records indicated that \$6.6 million was unused and was available for public bus transportation programs in the Virgin Islands. However, the local news media reported that the company which had the contract to provide public bus transportation had terminated its contract in January 1998 because it had not received payment from the Government.

Similarly, during the period of August 1991 to September 1997, the Transportation Office was awarded seven Federal grants, totaling \$927,000, from the Federal Transit Administration for the purchase of specialized buses for elderly and handicapped persons. However, the Federal Transit Administration's records as of January 31, 1998, indicated that \$830,000 was unused and available for the purchase of the specialized buses. In November 1997, the Transportation Office initiated requisitions for the purchase of four specialized buses, totaling \$207,000, but as of January 31, 1998, none of the buses had been received.

Federal Highway Administration Grants. Although the Federal-Aid Highway Program Office hired qualified personnel to oversee the highway projects, we found, based on records at the Department of Public Works, that the Federal-Aid Highway Program Office had 52 projects, totaling \$37.5 million, for which \$13.7 million remained unexpended as of March 31, 1998. Although the Federal-Aid Highway Program Office allocated its Federal awards to approved projects on a yearly basis, projects took several years to complete because of the extensive planning, design, and right-of-way acquisition phases associated with highway projects. As a result, grant funds for such highway projects as the Christiansted Bypass project on St. Croix remained available but unused for as long as 7 years.

Environmental Protection Agency Grants. During the period of 1984 to 1995, the Environmental Services Division was responsible for the administration of five Federal grants, totaling \$20 million, for solid waste treatment, used oil disposal, and wastewater treatment projects. As of January 31, 1998, only \$3 million had been expended against these Federal grants. For example, we found that, although a Federal grant totaling \$11 million was awarded in 1984 for the construction of a wastewater treatment facility, the facility's design, which was the responsibility of the Government of the Virgin Islands, had not been approved by the U.S. Environmental Protection Agency and that the costs to construct the facility had increased between 1984 and 1998 to \$23 million. The Director of Environmental Services said that the additional \$12 million needed to construct the facility would be secured through the Government's refinancing of bonds, which was concluded in May 1998.

Department of Education

With respect to Federal grants, the Department of Education was primarily responsible for the administration of a \$17.6 million block grant, which was awarded for a 2-year period (October 1995 to September 1997). The block grant was allocated among approximately 20 projects within the Department of Education and 1 project within the Department of Health. We found that the Department of Education had not submitted its annual Financial Status Report as of January 31, 1998, for the fiscal year ended September 30, 1997, because the Department had not liquidated all of the encumbrances against the block grant. In addition, the Department had not submitted, to the grantor agency, a request for extension of time to file the annual report and to liquidate encumbrances, as required by the Code of Federal Regulations.

The Code of Federal Regulations (34 CFR 80) states: "A grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period ... to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee." However, a Department of Education official told us that the Department did not comply with the Code's requirement because the Department did not become aware of the requirement until the Government's single audit report for the fiscal year ended September 30, 1994, was issued in December 1996 and that the Department was hampered in liquidating obligations in a timely manner because of the "cumbersome procurement process." For example, in November 1995, the Department of Education initiated a purchase for educational supplies by processing a "Requisition-Order-Invoice-Voucher" form. However, the document was not returned to the Department of Education for payment purposes until October 1996, and it took almost 1 year to liquidate the obligation for the educational supplies after initiation of the purchase.

The Department of Education's Director of Business Affairs told us that the procurement process was as follows: (1) a school initiates a requisition to purchase an item, (2) the requisition is approved by the Insular Superintendent of the district, (3) the requisition is sent to the Department's Procurement Division for a list of vendors, (4) the requisition is transmitted to the Department's Business Office for certification of funds, (5) the requisition is transmitted to the Department of Property and Procurement for solicitation of bids, (6) the requisition is transmitted to the Department of Finance for the identification of an encumbrance number, (7) the requisition is returned to the Department of Education's Procurement Division for mailing to the vendor, (8) the vendor signs an acceptance copy of the requisition and ships the items to the Department's warehouse, (9) the warehouse receives the items and processes the receiving reports, (10) the items are transmitted to the school and a school official signs the receiving report, and (11) the Department's Procurement Division sends the receiving report to the Business Office for transmittal to the Department of Finance for payment. This process routinely took over 1 year to complete.

We believe that to effectively use available Federal grant funds, the Government needs to establish a comprehensive grant management system. In addition, we believe that the

Department of Education, in cooperation with the Department of Property and Procurement, should conduct an analysis of its internal procurement process in an attempt to streamline the procedures without compromising existing controls. Further, the Department should request extensions to file its annual Financial Status Reports and liquidate outstanding encumbrances if it cannot accomplish these tasks within the **90-day** time frame specified in the Code of Federal Regulations.

Recommendations

We recommend that the Governor of the Virgin Islands:

1. Require the Office of Management and Budget to develop and implement a comprehensive Federal grant management system that requires all Government agencies to provide the Office with copies of all applications for Federal grants and other grant award and **drawdown** information; uses this input **from** Government agencies as the basis for a Federal grant database that includes, for each grant, the grant program name, the Catalog of Federal Domestic Assistance (CFDA) number, the Federal grantor agency name, the grantor agency's internal grant number, the Virgin Islands grantee agency name, the Virgin Islands Financial Management System account number, the grant period, the total grant award amount, the total amount of drawdowns made against the grant, and copies of annual financial reports; monitors the use of Federal grant funds within required time frames and compliance with local matching requirements; and ensures that Government agencies submit required annual and other grant financial status reports in a timely manner.

2. Require the Office of Management and Budget to provide the Federal Grants Management Unit with the staff and resources necessary for effective implementation of the recommended comprehensive Federal grant management system.

3. Require the Department of Finance to establish procedures, as a part of the Accounting Manual, to ensure that electronic fund transfers are promptly identified and recorded, through the use of Statement of Remittances, to the appropriate fund accounts upon receipt from the Federal grantor agencies or any other sources. The procedures should require Government agencies that receive monies through electronic fund transfers to provide the Department of Finance, immediately upon notification from the Federal grantor agency or other source, with photostatic copies of approved electronic fund transfer documents and any other pertinent information needed by the Department of Finance to record the transfers in the Financial Management System.

4. Require the Department of Finance to establish procedures to determine the amount of interest income earned on future electronic transfers of Federal funds that are not immediately released for payment and remit the interest income amounts to the U.S. Treasury, as required by the Code of Federal Regulations (31 CFR 205).

5. Require the Transportation Office, Department of Public Works, to maintain, for Federal grants that it administers, Federal grant program files which include copies of all

applications for Federal grants; award, drawdown, and other pertinent **grant** management information; and copies of grant financial status reports

6. Require the Department of Public Works to develop a plan of action to effectively use Federal Transit Administration, Federal Highway Administration, and U.S. Environmental Protection Agency funds that are available for approved projects.

7. Require the Department of Education, in cooperation with the Department of Property and Procurement, to undertake a study of its internal requisition and vendor payment processes, with the objective of streamlining and automating as many functions as possible. Also, sufficient internal controls should be instituted to safeguard against unauthorized or improper purchases of goods and services and payments to vendors.

Governor of the Virgin Islands Response and Office of Inspector General Reply

On June 30, 1998, we transmitted a draft of this report to the Governor of the Virgin Islands requesting a response by August 7, 1998. On August 20, 1998, we received a response (Appendix 5), dated August 7, 1998, from the Governor of the Virgin Islands. The response concurred with all seven recommendations. Based on the response, we consider Recommendations 1, 2, 3, and 7 resolved and implemented and request additional information for Recommendations 4, 5, and 6 (see Appendix 6).

C. LONG-STANDING PROBLEMS

The Government of the Virgin Islands needs to make Governmentwide procedural changes to correct long-standing problems in the areas of financial management, expenditure control, revenue collection, and program operations that have an impact on its financial condition. Our September 1994 special report on the status of financial management improvements (see Prior Audit Coverage section of this report) discussed these long-standing problems and presented goals for improvement for the Government. Although the Government's responses to audit recommendations have generally addressed the specific findings and questioned costs discussed in the prior audit reports, the Government has not made extensive changes in its operating procedures and practices to prevent similar problems and questioned costs from recurring and has not established a plan of action to achieve the improvement goals discussed in the 1994 report. In our opinion, the continued existence of these long-standing problems has contributed to the Government's current financial crisis, as evidenced by the \$588 million in operations-related obligations as of September 30, 1997 (see Finding A).

Goals for Improvement

In the September 1994 special report on the status of financial management improvements, we presented four goals that the Government should strive to achieve in order to realize long-term improvements in financial management, expenditure control, revenue collection, and program operations. These improvement goals were based on our analysis of the recommendations that we made in audit reports on specific agencies and programs of the Government and are summarized as follows:

- Effective financial management should include the ability to (1) accurately account for Federal and local funds and property and provide timely and accurate reports to Government managers and grantor agencies; (2) establish budgets based on realistic revenue projections, make allotments based on actual revenues, limit expenditures to approved allotment and appropriation levels, and control bonded and other long-term debt; (3) establish and maintain a central clearinghouse for Federally funded programs, ensure compliance with the Single Audit Act and specific grant program requirements, and accurately record grant program transactions; and (4) maintain an active, independent, and objective internal audit function.

- Effective procurement and supply management should include the ability to (1) procure quality goods and services at the lowest cost and in accordance with applicable Federal and local procurement regulations and (2) provide goods and services to agencies and pay vendors and contractors within reasonable time frames.

- Effective revenue collection should include the ability to (1) accurately determine and account for all funds due the Government and (2) promptly assess and collect such funds.

- Effective program operations should include the ability to (1) provide basic services and infrastructure facilities in an efficient and effective manner and (2) recruit qualified

personnel needed to carry out program objectives and establish a comprehensive personnel merit system for all employees.

With regard to the Government's current financial difficulties, we believe that if the Government had taken long-term corrective actions in response to the recommendations made in about 150 audit reports we have issued since October 1982 (when the Office of Inspector General assumed responsibility for Federal audit oversight in the Virgin Islands), the Government would have been in a better financial position as of September 30, 1997. Specifically, our audit reports have repeatedly included recommendations for the Government to improve financial management, improve its ability to maximize revenue collections, reduce operating expenses (particularly in the area of procurement), and increase the efficiency and effectiveness of program operations. Although the Government, in its responses to our audit recommendations, has generally addressed the specific problems or the questioned costs discussed in the audit reports, it often has not addressed recommended long-term changes in its operating procedures. The Virgin Islands Bureau of Audit and Control has also made recommendations in about 290 audit and memorandum reports issued since May 1982 (when that Bureau was established) that, if implemented, could have resulted in improved financial management practices within the Government. Further, the Government's single audit reports, which have reported on the results of independent audits of Federal financial assistance received by the Government during fiscal years 1982 through 1994, have included recommendations to address Governmentwide internal control weaknesses that adversely impact the administration of Federal grant funds.

We further believe that the Government will be able to correct its current financial crisis only by making significant changes in its financial management practices. Specifically, the Government should monitor and report on its financial condition through audited financial statements issued in a timely and accurate manner, aggressively collect amounts owed, comply with competitive procurement requirements, control the number of its employees and the related payroll costs, and promote more efficient and effective program operations. All of these issues relate to the four improvement goals presented in the September 1994 special report. Although achievement of those improvement goals will not resolve the Government's immediate financial difficulties, we continue to believe that the improvement goals represent a basis for establishing a comprehensive plan of action to bring long-term improvements in Government operations that would ultimately benefit all Virgin Islands residents.

Recommendations

We recommend that the Governor of the Virgin Islands:

1. Require the Department of Finance to perform an assessment of the current and projected future financial accounting and reporting needs of the Government and seek the funding necessary to upgrade the Financial Management System's computer and software accordingly. In performing the needs assessment, input should be obtained from all user agencies and such factors as the number of on-line users, the volume of transactions,

compliance with the financial reporting requirements of generally accepted accounting principles and the Single Audit Act, and the special financial information needs and reporting requirements of agency management should be considered. Also, provisions should be made to ensure that users are properly trained and that a user-friendly operating manual for the Financial Management System is developed and distributed to all users.

2. Develop and implement an audit followup system to ensure that agencies implement agreed-to audit recommendations (whether made by the Office of Inspector General, the Virgin Islands Bureau of Audit and Control, internal auditors, or contracted independent auditors) or provide reasonable justification as to why the recommendations cannot or should not be implemented. As options, the budget process could be used to provide incentives for agencies to fully implement audit recommendations, and/or the Special Assistant to the Governor for Policy and Audit Resolution could report to the Governor, on at least a semiannual basis, the agencies that did not implement audit recommendations so that the Governor could follow up with the agency heads to require implementation.

3. Require and provide the Department of Property and Procurement with the authority to strictly enforce competitive procurement requirements. To the maximum extent possible, advertised invitations for bids should be used for the procurement of goods and construction services. In instances where emergency or other circumstances make formal advertised bids impractical for construction contracts and for all professional services contracts, requests for proposals and competitive negotiations should be used by following the requirements established in Title 3 1, Section 239(10), of the Virgin Islands Code and Title 3 1, Section 239-4, of the Virgin Islands Rules and Regulations. Also, special contingency plans should be developed to provide a mechanism for the Government, with a reasonable level of competition and management oversight, to obtain emergency debris removal and repair services in the event of future hurricanes or other natural disasters.

4. Establish an interagency task force, in coordination with a competitively selected outside collection agency, to review and update the accounts receivable records of all revenue-generating agencies of the Government; write off accounts that are deemed to be uncollectible; attempt to collect outstanding accounts that are deemed to be collectible; and establish procedures to ensure that bills are promptly issued for all amounts owed the Government, accounts receivable records are kept up to date, and effective collection enforcement actions are undertaken for all amounts owed the Government. Also, a control mechanism should be established that would require each revenue-generating agency of the Government to submit a quarterly report to the Office of Management and Budget which identifies the outstanding balance of accounts receivable for each type of revenue collected by the agency and require the Office of Management and Budget to summarize this information, at least on a semiannual basis, in a report to the Governor of any agency that was allowing its accounts receivable balances to increase significantly.

5. Require the Division of Personnel, in cooperation with the Office of Collective Bargaining and with participation by employee union representatives, to undertake a comprehensive review of the existing personnel merit system to include developing rules and

regulations for collective bargaining; updating job classifications and job descriptions; consolidating the Government's many salary and wage schedules; and resolving conflicts between existing laws concerning the types of positions that can be filled through appointments to unclassified positions.

Governor of the Virgin Islands Response and Office of Inspector General Reply

On June 30, 1998, we transmitted a draft of this report to the Governor of the Virgin Islands requesting a response by August 7, 1998. On August 20, 1998, we received a response (Appendix 5), dated August 7, 1998, from the Governor of the Virgin Islands. The response concurred with all five recommendations. Based on the response, we consider Recommendations 2 and 5 unresolved and request additional information for Recommendations 1, 3, and 4 (see Appendix 6).

Recommendation 2. Concurrence.

Governor of the Virgin Islands Response. The response stated that a "Quality Assurance Unit" was being developed "within the Department of Finance to provide the additional monitoring, procedural and review activities relative to the administration and conduct of operational units which internally and externally impact the timeliness of all financial reporting."

Office of Inspector General Reply. Although the proposed development of a "Quality Assurance Unit" within the Department of Finance is a positive step with regard to ensuring timely financial reporting, it does not fully address the recommendation, which calls for a Governmentwide audit followup system to ensure that Government agencies implement agreed-to audit recommendations. Therefore, we consider the recommendation unresolved.

Recommendation 5. Concurrence.

Governor of the Virgin Islands Response. The response stated that "the Division of Personnel has been working with the Office of Management and Budget and the Office of Collective Bargaining to establish a uniform listing of position classes within the merit system" and that "rules and regulations [have been developed] which govern relationships among the Division of Personnel, the Office of Collective Bargaining, and union representatives."

Office of Inspector General Reply. Although the proposed actions are positive steps with regard to improving personnel management practices, they do not fully address the recommendation, which calls for a comprehensive review of the Government's personnel merit system not just position classifications and labor-management relations. Therefore, we consider the recommendation unresolved.

CLASSIFICATION OF MONETARY AMOUNTS

<u>Finding</u>	<u>Questioned costs*</u>	<u>Funds To Be Put To Better Use**</u>
A. Interfund Loans and Other Obligations		
Interfund Loans	\$120 million*	
B. Federal Grants		
Department of Public Works		\$38.1 million**

* This amount represents a commingling of Federal and local funds. Therefore, a breakdown as to Federal or local funds cannot be determined.

** This amount represents Federal funds.

**SUMMARY OF OUTSTANDING OBLIGATIONS
AS OF SEPTEMBER 30, 1997,
AND JANUARY 31, 1998**

Description	Audited Outstanding Balances as of <u>Sept. 30, 1997</u>	Unaudited Outstanding Balances as of <u>Jan. 31, 1998</u>	Increase or (Decrease)
	<u>(Amounts in Millions)</u>		
Unauthorized Interfund Loans Owed Special Funds	\$120	\$120	0
Authorized Interfund Loans Owed Special Funds	21	21	0
Community Disaster Loans Owed FEMA	150	162	\$12
Retroactive Salary Increases Owed Employees	141	109	(32)
Income Tax Refunds Owed Taxpayers	76	26	(50)
Payments on Invoices Owed Vendors	67	25	(42)
Retirement Contributions Owed Retirement System	13	13	0
Authorized Loans for Tax Refunds and Vendor Payments Owed Banks	<u>0</u>	<u>106*</u>	<u>106</u>
Total Operations-Related Obligations	<u>\$588</u>	<u>\$582</u>	(\$6)

* Does not include interest accrued at 6.9 percent a year.



THE UNITED STATES VIRGIN ISLANDS

OFFICE OF THE GOVERNOR
GOVERNMENT HOUSE

Charlotte Amalie, V.I. 00802
809-774-0001

December 1, 1997

RECEIVED
OFFICE OF INSPECTOR GENERAL
IMMEDIATE OFFICE

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Honorable Wilma A. Lewis
Inspector General
U.S. Department of Interior
Office of Inspector General
Washington, D.C. 20240

Subject: Draft Advisory Report on the Status of Inter-fund Loans and other obligations of the Government of the Virgin Islands (Assignment No. V-IN-VIS-005-97-A)

Dear Inspector General Lewis:

We are in receipt of your **Draft** Advisory Report on the Status of **Interfund** Loans and other obligations of the Government of the Virgin Islands.

We take strong objection to the conclusions of this audit. The audit claims that the Administration borrowed \$120 million in unauthorized **interfund** loans during the period April, 1995 to September 30, 1997.

This is far from the truth. Our records for that same period show that over \$41 million was already borrowed before April 1, 1995. The checks drawn on the Payroll Fund totaling \$120 million, held at the Department of Finance on September 30, 1997, is not proof certain that \$120 million was actually borrowed during the period April, 1995 to September, 1997. The fact is that this total represents amount borrowed that remain unpaid, and the amounts legally authorized to be transferred from other **funds** to support operating expenses of the General Fund. More specifically, at the start of Fiscal Year 1995, October 1, 1994, the General Fund owed \$34.5 million to the Payroll Fund for further disbursement to the FICA and the Health Insurance Funds.

During Fiscal Years 1995 through 1997, legislation was enacted authorizing borrowings and transfers of \$49.9 million to support the operating expenses of the General Fund, which includes payroll. Act No. 6075 alone appropriated **\$14,897,230** from any funds available to satisfy Fiscal Year 1995 expenditures of the Legislature.

A summary of these Legislative Acts is provided below for your information:

1. Act No. **6086** appropriated \$5 million to satisfy the local match requirement.
2. Act No. **6119** appropriated \$10 million **from** any fund to satisfy the local match requirement for Hurricane Bertha and authorized the adjustment of any item of appropriation up to \$7 million in Fiscal Year 1996.
3. Act No. **6078** authorized the transfer of \$6 million **from** any **fund** to offset the General Fund revenue shortfall experienced due to the rollback of 1994 real property taxes to the 1992 assessment level.
4. Act No. 6075 appropriated **\$14,987,230 from** any funds available to satisfy Fiscal Year 1995 expenditures of the Legislature.
5. Act No. **6084** authorized the adjustment of any item of appropriation up to \$7 million in Fiscal Year 1995.

When one takes into consideration the authorized borrowings and transfers of \$49.9 million and the \$41 million of outstanding borrowings before April 1, 1997, it would be inaccurate to conclude that we had unauthorized borrowings of \$120 million **from** special and other funds, between April 1, 1995 and September 30, 1997.

Even though not substantiated, there is an implication that Federal funds were used to pay for General Fund payroll costs. **This** is totally incorrect. Our review of the draft comments **from** the 1995 single audit does not substantiate your position. Moreover, the overdraft status of Federal accounts more likely demonstrates that federal draws were not received by the time the federal disbursements were made. Most federal programs are drawn on a reimbursement basis, which means the special and other **funds** were used and reimbursed when the draw was executed.

We seriously question the figure of \$574 million as the “general operating obligations” of the Government. Only the current portion of long-term debt is considered for accounting purposes, as general operating obligations.

It must be noted that no malfeasance or other acts of misuse of government funds were found by your audit.

With the total disruption of **our** government, caused by three **100-year** storms, it was necessary for this Administration to take all steps to keep this government afloat, and to keep the entire community together.

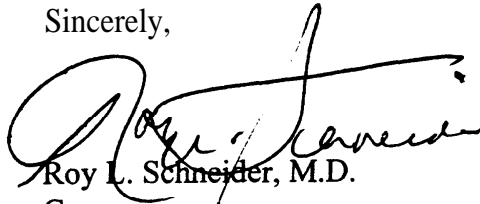
Honorable Wilma A. Lewis
December 1, 1997
Page 3

APPENDIX 3
Page 3 of 3

We are requesting that your final draft report be withheld until members of my Administration can prepare the necessary documentation to support our conclusions and to respond to other audit findings.

Please feel free to contact me should you have any questions about this matter.

Sincerely,



Roy L. Schneider, M.D.
Governor

s:wilma.121



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

FEB 5 1998

Honorable Roy L. Schneider
Governor of the Virgin Islands
No. 21 Kongens Gade
Charlotte Amalie, Virgin Islands 00802

Subject: Response to Draft Advisory Report "Status of **Interfund** Loans and Other Obligations. Government of the Virgin Islands" (Assignment No. V-IN-VIS-005-97-A)

Dear Governor Schneider:

On November 2 I, 1997, we requested that you respond, by December 3, 1997, to the subject draft report. The **draft** report further stated that your comments **had** to be submitted by that due date to ensure that they would be included in the final version of the report. Unfortunately, we did not receive your response, dated December 1, 1997, and postmarked December 29, 1997, until January 6, 1998. Since we received your comments after the final report (No. 98-I-187) was issued, this letter presents **our** responses to the statements (parenthetically referenced) included in your letter as follows:

- **"We take strong exception to the conclusions of this audit. The audit claims that the Administration borrowed \$120 million in unauthorized inter-fund loans during the period April, 1995 to September 30, 1997."** (Page 1, paragraph 2)

"This is far from the truth. Our records for that same period show that over \$41 million was already borrowed before April 1, 1995. The checks drawn on the Payroll Fund totaling \$120 million, held at the Department of Finance on September 30, 1997, is not proof certain that \$120 million was actually borrowed during the period April, 1995 to September, 1997. The fact is that this total represents amounts borrowed that remain unpaid, and the amounts legally authorized to be transferred from other funds to support operating expenses of the General Fund. More specifically, at the start of Fiscal Year 1995, October 1, 1994, the General Fund owed \$34.5 million to the Payroll Fund for further disbursement to the FICA and the Health Insurance Funds." (Page 1, paragraph 3)

Contrary to the statement that "the checks drawn on the Payroll Fund totaling \$120 million, . . . is not proof certain that \$120 million was actually borrowed during the period April, 1995 to September, 1997," our review of the 87 checks showed that, although they were dated from September 9, 1995, through September 12, 1997, the checks were for repayment of

FICA and health insurance expenses related to the pay periods April 1-24, 1995, through July 18-31, 1997. Further, the statement that "The fact is that **this total** represents amounts borrowed that remain unpaid" supports our conclusion that **\$120 million in interfund loans** was outstanding as of September 30, 1997.

If, **as** stated in **your** response. "over \$41 million was already **borrowed** before April 1, 1995," then that \$41 million was in addition to, not a part of, the \$120 million discussed in our report. Our auditors physically examined the 87 checks, totaling **\$120 million**, that were held by the Department of Finance as of September 30, 1997, and we stand by the statements made in the report. With regard to unauthorized, unrecorded **interfund loans** that may have been made prior to April 1995, we stated in the report (page 8) that "we were not able to determine whether additional unrecorded **interfund** loans were made during fiscal year 1995 but were repaid prior to September 30, 1997." The reason we were unable to determine the existence of or comment on **interfund** loans that may have been repaid prior to September 30, 1997, was that such loans were not recorded in the official financial records of the Government of the Virgin Islands; therefore, they were not readily traceable.

Your statement that "at the start of Fiscal Year 1995, October 1, 1994, the General Fund owed \$34.5 million to the Payroll Fund for further disbursement to the FICA and the Health Insurance Funds" raises serious concern about the accuracy of the General Purpose Financial Statements included in the single audit report for the fiscal year ended September 30, 1994 (which was issued by **KPMG/Peat Marwick** in December 1996). Specifically, Note 6 ("**Interfund Transactions**") to the General Purpose Financial Statements does not include an amount of \$34.5 million that the General Fund owed to the Payroll Fund as of September 30, 1994 (which would have been carried forward to beginning balances on October 1, 1995). In our opinion, the omission of a \$34.5 million **interfund** debt would constitute a material departure **from** generally accepted accounting principles.

"During Fiscal Years 1995 through 1997, legislation was enacted authorizing borrowings and transfers of \$49.9 million to support the operating expenses of the General Fund, which includes payroll." (Page 1, paragraph 4)

"When one takes into consideration the authorized borrowings and transfers of \$49.9 million and the \$41 million of outstanding borrowings before April 1, 1997, it would be inaccurate to conclude that we had unauthorized borrowings of \$120 million from special and other funds, between April 1, 1995 and September 30, 1997." (Page 2, paragraph 2)

As discussed in the previous paragraphs, the \$41 million is not a part of the \$120 million, based on our review of available records. In regard to the five legislative acts, with appropriations totaling \$49.9 million, we noted the following:

✕ - Act No. 6086 appropriated **from** the 1996 Internal Revenue Matching Fund "in the **fiscal** year ending September 30, 1996, the **sum** of \$5 million, or so much thereof as **may** be necessary, as a portion of the match share required of the Government of the Virgin Islands pursuant to the Federal Emergency Assistance Act (the **Stafford Act**), Public Law

93-288, as amended, 42 U.S.C. 1512 et seq., to begin immediate assistance to individuals and families as authorized by law.” The Act **further** states: “The Governor is **authorized** to use the monies appropriated by this Act to match federal funding to the extent such **match** is required prior to any decision by the President of the United States or the Congress to extend full federal coverage of the disaster relief program. In the event **100% Federal funding** is authorized, further expenditure of **funds** pursuant to this act shall cease.” Also, ~~the Act~~ states, “It is the intent of this act to allow for the immediate commencement of the **Individual and Family Grant Program** under the approved 90% to 10% ratio now authorized by the President of the United States, and not to delay **funding** pending a more favorable ratio.” Based on these statements, we believe that these funds were appropriated by the Legislature as the required local match for Federal funding for emergency disaster assistance relief following **Hurricane Marilyn** in September 1995 and not for Government payroll expenses. (See page 8 of **the** final report.)

- Act No. 6119 appropriated “in the fiscal year ending September 30, 1996, the sum of **\$10** million, or so much thereof as may be necessary, to match any federal funds authorized by the Presidential Disaster Declaration related to Hurricane Bertha.” The Act further states: “The Governor is authorized to use the monies appropriated by this act to match federal funding to the extent such match is required prior to any decision by the President of the United States or the Congress to extend **full** federal coverage of the disaster relief program. In the event 100% Federal funding is authorized, further expenditure of **funds** pursuant to this section shall cease.” **Also**, the Act states, “It is the intent of this section to allow for the immediate commencement of all programs under the approved 75% to 25% ratio now authorized by the President of the United States, and not to delay funding pending a more favorable ratio.” Based on these statements, we believe that these funds were appropriated by the Legislature **as** the required local match for Federal funding for emergency disaster assistance relief following Hurricane Bertha in **July** 1996 and not for Government payroll expenses.

Act No. 6119 amended Act No. 6084 (see Act No. 6084 below) by deleting the phrase “fiscal year ending 1995” and substituting the phrase “fiscal year ending 1996.” Act No. 6084 authorized the Director of the Office of Management and Budget to adjust “any item of appropriation in the budget of the Government of the Virgin Islands for the fiscal year ending September 30, 1995, to provide that fixed mandatory costs be paid, including but not limited to payroll, utilities, rents, and ongoing contractual obligations.” Act No. 6084 further states that “the total net adjustments authorized pursuant to ...**this** act shall not exceed seven million dollars (**\$7,000,000**) which sum is hereby appropriated for that purpose in the fiscal year ending September 30, 1995.” Also, Act No. 6084 states, “Within 30 days after the close of fiscal year 1995, the Director of the Office of Management and Budget shall report to the Legislature all reconciliations made pursuant to this act.” As stated in our **final** report (page 8), this act, in our opinion, did not authorize the **interfund** borrowing of monies that were not appropriated but the transfer of monies among appropriations to pay for fixed mandatory costs. Even if Act No. 6084, as amended by Act No. 6119, did authorize **interfund** borrowing, such authorization should have been limited to \$7 million and **only** during fiscal year 1996. As of September 30, 1997, the outstanding balance of unrecorded **interfund** loans made during fiscal year 1996 totaled \$48 million (out of the \$120 million total

amount of such loans). We were not able to determine whether additional unrecorded **interfund** loans were made during fiscal year 1996 but were repaid prior to September 30, 1997.

- Act No. 6078, passed in August 1995, states that “residential real property taxes owed for the tax year 1994 shall be maintained at the 1992 rate of assessment.” The Act further states, “The Governor of the Virgin Islands through the Commissioner of Finance, is hereby authorized to transfer six million dollars (\$6,000,000) **from** any funds available in the **Treasury** of the Government of the Virgin Islands to offset the decrease in revenue that occurs as a result of the residential property tax assessment moratorium.” Accordingly, because of the rollback in property taxes (from the fiscal year 1994 level to the fiscal year 1992 level), the Government was authorized to make up the shortfall by transferring \$6 million **from** any **funds** available in the Treasury. However, as of September 30, 1997, a transfer of \$6 million **from** any other fund to the General Fund in accordance with this act had not been recorded in the **official** records of the Government. Therefore, although this amount could be used to repay \$6 million of the \$120 million in unauthorized **interfund** loans, the transfer of \$6 million from any other fund to the General Fund would have to be recorded in the official records of the Government.

- Act No. 6075 appropriated \$14.9 million “**from** any available funds in the Treasury of the Virgin Islands for expenditure by the Legislature in the fiscal year ending September 30, 1995.” We did not obtain confirmation **from** the Government’s Department of Finance that the \$14.9 million was transferred **from** any other fund to the General Fund for expenditures of the Legislature. In our opinion, even if the transfer had been made, these funds would have been earmarked for expenditures of the Legislature and not for payroll expenditures of the executive branch of the Government.

- Act No. 6084 (see Act No. 6119 above) authorized the Director of Management and Budget to “adjust any item of appropriation in the budget of the Government of the Virgin Islands for the fiscal year ending September 30, 1995” and limited such “adjustments” to a maximum of \$7 million. All reconciliations made pursuant to this act were required to be reported by the Director of Management and Budget to the Legislature within 30 days after the close of fiscal year 1995. As stated in the **final** report (page 8), this law, in our opinion, did not authorize the **interfund** borrowing of monies that were not appropriated but the transfer of monies among appropriations. Even if Act No. 6084 authorized **interfund** borrowing, such authorization would have been limited to \$7 million and only during fiscal year 1995. As of September 30, 1997, the outstanding balance of the unauthorized **interfund** loans made during fiscal year 1995 totaled \$18.2 million (out of the \$120 million total amount of such loans). We were not able to determine whether additional unauthorized **interfund** loans were made during fiscal year 1995 but were repaid prior to September 30, 1997.

Based on the forgoing discussion of the five legislative acts referenced in your response, we maintain that \$120 million borrowed without legal authorization from the Special and Other Funds bank account to cover the **payroll-related** expenses for FICA taxes and health insurance premiums for pay periods April 11-24, 1995, through July 18-31, 1997, remained outstanding as of September 30, 1997. The only reduction to this amount would be the \$6 million based

on Act No. 6078 but only after the \$6 million transfer from any other fund to the General Fund is recorded in the financial records of the Government. Deduction of this **amount** would still leave a balance of \$114 million borrowed without specific legislative authority.

- **“Even though not substantiated, there is an implication that Federal funds were used to pay for General Fund payroll costs. This is **totally incorrect**. Our review of the draft comments from the 1995 single audit does not substantiate your position. Moreover, the overdraft status of Federal accounts more likely demonstrates that federal draws were not received by the time the federal disbursements were made. Most federal programs are drawn on a reimbursement basis, which means the special and other funds were used and reimbursed when the draw was executed.” (Page 2, paragraph 3)**

We cannot comment on the contents of the draft 1995 single audit report because the report has not been finalized and submitted to us for a cognizant agency review. (The single audit report for fiscal year 1994, which was dated December 1996, was not submitted to us until November 1997.) However, the absence of comments in the single audit report with regard to the **overdraft** of Federal grant accounts does not guarantee that no overdrafts occurred. In conducting the single audit, the independent auditors are required to review only a statistical sample of transactions for grant accounts that are classified as “major programs,” as defined in the Single Audit Act. For example, only 15 of the 118 Federal grant programs listed in the Schedule of Federal Financial Assistance were classified as “major programs” and included in the scope of the independent auditors’ review for the fiscal year 1994 single audit.

Our **final** report (page 7) states, “We reviewed the activity in **the** Special and Other Funds bank account and found that the account was overdrawn on 141 days during fiscal years 1996 and 1997, including by \$12 million on December 4, 1995.” The report further states, “Because the Special and Other Funds bank account commingled both local and Federal **funds** and **the** bank account was overdrawn on many occasions, including amounts of up to \$12 million, we believe that Federal **funds** may have been borrowed to pay for non-Federal payroll-related expenses.” In our opinion, there is a low probability that none of the Government’s 118 Federal grant programs had unexpended balances on all 141 days on which the Special and Other Funds bank account was overdrawn. Therefore, we could not readily determine, at the time the advisory report was issued, whether Federal grant **funds** were used to pay General Fund payroll expenses.

Nevertheless, we are continuing our fieldwork on the Federal grants portion of the **audit** to determine whether (1) drawdowns were made for particular expenditures on a Federal grant but a payment was not made in a timely manner or a check was prepared and not issued by the Department of Finance in a timely manner for these expenditures; (2) Federal grantor agencies provided grantees with funds in excess of their immediate cash needs; and (3) drawdowns were based on encumbrances and not payment documents. The results of our review in these areas should provide **sufficient** evidence to conclude whether Federal **funds** were used for **other** than grant-related expenses.

With regard to the timing of grant drawdown requests, based on our ongoing review, we have determined that, for the Government agencies with the largest **amount** of Federal **grant** funds, such as the Departments of Health and Education, **drawdowns** are made either at the **time** that payment documents are submitted to the Department of Finance for processing or at the time that the checks are prepared by the Department of Finance but in both **cases** before the checks are issued. Accordingly, those grant accounts should not have experienced an overdrawn condition or required non-grant funds to pay these expenses because sufficient funds should have been available in the Special and Other Funds bank account **from** the drawdowns.

- **"We seriously question the figure of \$574 million as the 'general operating obligations' of the Government. Only the current portion of long-term debt is considered for accounting purposes, as general operating obligations." (Page 2, paragraph 4)**

We did not identify the \$570 million as "general operating obligations" but as a "total operating debt," with the intention of differentiating it **from** bonded debt, which is generally incurred for the purpose of **funding** capital improvement projects. All of the items included in the \$570 million amount were incurred either as a result of the Government's general operations or to finance general operating expenses. Because the purpose of the advisory report was to inform senior-level Government officials of the total outstanding obligations of the Government to assist them in making informed decisions, both short- and long-term, regarding those obligations and their impact on the Government's ability to meet its **general operating** expenses, we believe that inclusion of the entire amount owed is appropriate. Nevertheless, the only portion of the \$570 million that could be considered long-term debt is the \$150 million in disaster loans owed to the Federal Emergency Management Agency (**FEMA**) and, in that **regard**, the **final** report (page 12) states that "we recognize that the **FEMA** loans are to be repaid over a period of up to 10 years."

- **"It must be noted that no malfeasance or other acts of misuse of government funds were found by your audit." (Page 2, paragraph 5)**

The **final** report (page 3) states that the overall objective of our audit, as amended, is to determine (1) all amounts borrowed by the General Fund **from** special **fund** accounts during fiscal years 1995, 1996, and 1997 and (2) the outstanding balances of such **interfund** loans and the unobligated balances of Federal grant accounts. The purpose of the advisory report was to provide Government officials with preliminary information on the **status** of **interfund** loans and other outstanding obligations to allow them to make informed decisions on the **Government's** finances. Our audit objective did not include the identification of "malfeasance or other acts of misuse of government funds." As such, we did not draw any conclusions on this matter in the advisory report. However, the discovery of any "malfeasance" during the conduct of our audit would be referred to the proper authorities and not disclosed in **an** audit report, which usually addresses systemic, control, or procedural deficiencies that may have facilitated or increased the risk for acts of malfeasance.

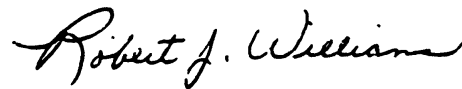
- **"With the total disruption of our government, caused by three 100-year storms, it was necessary for this Administration to take all steps to keep this government afloat, and to keep the entire community together." (Page 2, paragraph 6)**

We **certainly** recognize the severe impact on the infrastructure, the economy, and the lives of the residents of the Virgin Islands that resulted **from** the three recent **hurricanes**. The **final** report (page 11) **acknowledges** that the decline in the Government's financial condition "was made worse by the economic downturn and extraordinary expenses that **resulted** from Hurricanes Hugo in 1989, **Marilyn** in 1995, and Bertha in 1996." However, given those financial hardships, we believe **that** the Government should have been more **diligent** in controlling expenditures, collecting revenues, and managing its finances. Our audits of Government agencies continue to disclose instances of major procurements being made without competitive procedures being followed, of millions of dollars in revenues going uncollected, and of inaccurate financial records. In our advisory report (page 11), we concluded that "the [Government's] financial condition could have been strengthened through more diligent efforts by the Government to address financial management deficiencies" and to implement our audit recommendations.

With regard to the \$120 million in unauthorized, unrecorded **interfund** loans, we believe that the Government should have (1) sought specific legislative approval for **interfund** loans (from non-Federal and otherwise unrestricted accounts) to pay the payroll costs that exceeded available General Fund balances and (2) recorded those interfund loans in the official financial records at the time that the loans were made.

If **you** have any questions about this matter, please contact Mr. Arnold E. van Beverhoudt, Jr., Director of Insular Area Audits, at (340) 774-8300.

Sincerely,

A handwritten signature in cursive script, reading "Robert J. Williams".

Robert J. Williams
Acting Inspector General



THE UNITED STATES VIRGIN ISLANDS

OFFICE OF THE GOVERNOR
GOVERNMENT HOUSE

Charlotte Amalie, V.I. 00802
809-774-0001

August 7, 1998

Honorable Robert J. Williams
Acting Inspector General
U. S. Department of Interior
Office of Inspector General
Washington, DC 20240

Subject: Draft Audit Report on Interfund Loans and Federal Grant Balances,
Government of the Virgin Islands (Assignment No. V-IN-VIS-005-97)

Dear Acting Inspector General Williams:

This is to acknowledge receipt of your Draft Audit Report on "Interfund Loans and Federal Grant Balances for the Government of the Virgin Islands." The following is the response to the Findings and Recommendations included in your Draft Report after an **indepth** and exhaustive review of this Draft Report.

INTERFUND LOANS AND OTHER OBLIGATIONS

Let me focus on three areas of importance, namely, (1) Unauthorized borrowings, (2) Lack of Recording Interfund Loans, and (3) Federal Funds used to cover the overdrawn condition of the Special and Other Funds Bank Account.

(1) Unauthorized Borrowings

We maintain that the Department of Finance, at no time, borrowed funds in excess of the authorized \$15 million to meet payroll costs, as authorized by Act No. 6068. This issue was raised and clarified in the exit conference, although the only appearance of this clarification is found in a footnote on page 10 of the Audit Report. We would like to also reiterate that the Department of Finance did not illegally borrow \$120 million from Special and Other Funds to pay General Fund obligations were **well** within our legal authorization. We are all **well** aware that Disaster loan funds received from FEMA after Hurricanes Hugo and Marilyn were insufficient to cover revenue losses. As a result, our operating expenses exceeded our revenues, however, at no time did the Department or this Administration state that these borrowings were solely to meet payroll expenses. We have always maintained the borrowings were used to meet all operating expenses of the Government, which include payroll costs.

During fiscal years 1995-1997, there were many Acts passed by the Legislature of the Virgin Islands allowing the Governor through the Department of Finance and/or the Office of Management and Budget to manage the severely strained financial resources of the Government. These Acts were presented to the Office of Inspector General in our earlier Responses, including the Act

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contained in the Virgin Islands Code, Title 23, Section 1125, which authorizes the Governor to utilize all available resources of the Territory while under a State of Emergency. The majority of the borrowings were covered by this legislation **since** the State of Emergency declaration was in effect from September 15, 1995 through January 1, 1997.

My Administration stands by its position that all interfund borrowings and interfund transfers from Special and Other Funds were legally authorized during the period covered by this Audit.

(2) Lack of Recording Interfund Loans

The Department is presently in the process of recording all interfund borrowings and interfund transfers from the Special and Other Funds to the General Fund. Personnel of the Department are engaged in the reconciliation of the various funds involved.

(3) Federal Funds Used to Cover the Overdrawn Condition of the Special and Other Funds Bank Account

The Department of Finance strongly objects to your conclusion that Federal funds were used to cover the overdrawn conditions of the Special and Other Funds checking account. We have communicated this to your auditors on many occasions. The "Show Me" approach that has been taken by the auditors from your office in conducting this audit has left us with an unreasonable burden of proof. Based on our review of your workpapers documenting the 76 instances in which the Special and Other Funds bank account was overdrawn, it appears that they neglected to review the group of bank accounts that provide funding for Special and Other Funds obligations. There are two checking accounts and one savings account used to manage the receipts and disbursements of Special and Other Funds. When you review the total cash available to support Special and Other Funds checks, which includes those funded by Federal programs, we believe the conclusions of this audit will change dramatically. In fact, you will find that there has been no use of Federal Funds to cover the so-called overdrawn condition of the Special and Other Funds Bank Account. Funds are left on deposit in savings accounts to maximize our earnings capabilities. The ideal solution to be able to maximize interest earnings on idle cash would be to have a zero balance checking account. However, when the Special and Other Funds checking account was originally established, the depository of that account did not offer that service.

The Department of Finance has always maintained that cash from the local portion of the Special and Other Funds group of bank accounts has been supplementing the Federal portion. To demonstrate this, the Department has begun a review of expenditures versus drawdowns for Federally funded programs. The results of our review thus far have supported our position. In fact, our review of expenditures for Federal programs and related drawdowns for the Department of Public Works for the period October 1, 1995 through July 31, 1997 shows a significant excess of cash disbursements over cash receipts. This is the same period of the audit, therefore, it could be concluded that a large percentage of the overdrafts could have resulted from Departments and agencies of the Government not drawing Federal funds on a timely basis.

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We have recognized for some time the need for better and more efficient control of Federal Funds. A separate bank account has been established for that purpose and will become operational October 1, 1998.

FEDERAL GRANT BALANCES

We concur that the Department of Finance has experienced problems recording certain Federal electronic fund transfers. This occurs when the wire information received from the bank does not include sufficient information to identify the Federal Program. The Department has begun to remedy the problem through the issuance of policy memoranda to departments and agencies on **drawdown** requests.

The Department also concurs that there are unusual circumstances where a department or agency had initiated **drawdown** requests prior in the Department of Finance completing its payment process. However, this is the exception. The Department has implemented a new process that allows departments and agencies to make drawdowns based on a system generated report which details all payments processed by the Department for their Federal program. This new process was implemented on April 30, 1998.

The United States Department of Treasury conducted an audit of the Federal Programs which fall under the 1990 Cash Management Improvement Act, and the results showed that there were no violations. As a result, no interest liability was levied against the Government.

LONG STANDING PROBLEMS

The Department of Finance in conjunction with other government departments and agencies continues to develop, implement and execute financial policy and procedures to meet the changing needs of the Government of the Virgin Islands. To that end, we fully concur with your recommendation that the Department perform an assessment of current and future financial accounting and reporting needs of the Government.

RESPONSES TO RECOMMENDATIONS

We recommend that the Governor of the Virgin Islands:

1. REQUIRE THE DEPARTMENT OF FINANCE TO RECORD IN THE FINANCIAL MANAGEMENT SYSTEM THE \$120 MILLION BORROWED BY THE GENERAL FUND FROM THE SPECIAL AND OTHER FUNDS BANK ACCOUNT TO PAY FICA TAXES AND HEALTH INSURANCE PREMIUMS FOR PAY PERIODS DURING APRIL 1995 TO JULY **1997**. SPECIFICALLY, THE DEPARTMENT SHOULD PROCESS JOURNAL ENTRY TRANSACTIONS TO ESTABLISH A DUE TO OTHER FUNDS LIABILITY ACCOUNT IN THE GENERAL FUND IN THE AMOUNT OF \$120 MILLION AND A DUE FROM OTHER FUNDS RECEIVABLES ACCOUNT IN EACH OF THE SPECIAL FUNDS FROM WHICH MONIES WERE BORROWED FOR EACH FUND'S APPROPRIATE SHARE OF THE \$120 MILLION INTERFUND LOAN. IN ADDITION, THE DEPARTMENT OF FINANCE SHOULD PROVIDE A REPORT TO THE LEGISLATURE EXPLAINING THE USES MADE OF THE AMOUNTS BORROWED WITHOUT LEGISLATIVE AUTHORIZATION AND THE STATUS OF REPAYMENT SO THAT INFORMED DECISIONS ON THE GOVERNMENT'S FINANCES CAN BE MADE AS THEY PERTAIN TO THE FUND ACCOUNTS AFFECTED BY THIS UNAUTHORIZED **INTER-FUND DEBT**.

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RESPONSE # 1

We concur. The Department of Finance will review the activity between General Fund and Special and Other Funds to assure that all applicable transfers are recorded. Processes have been implemented to timely capture and record transfers due to/from appropriate funds.

The Department of Finance will provide an appropriate report to the Legislature explaining the uses of amounts borrowed with legislative authorization.

2. REQUIRE THE DEPARTMENT OF FINANCE AND THE OFFICE OF MANAGEMENT AND BUDGET TO DEVELOP AND SUBMIT FOR LEGISLATIVE APPROVAL A PLAN OF ACTION TO LIQUIDATE THE \$120 MILLION UNAUTHORIZED INTERFUND DEBT. THE PLAN OF ACTION SHOULD ENSURE THAT ANY FEDERAL FUNDS INCLUDED IN THE BORROWED AMOUNTS ARE GIVEN FIRST PRIORITY FOR REPAYMENT IN FULL, ANY SPECIAL FUNDS THAT WERE SUBJECT TO LEGISLATIVE, CONTRACTUAL, OR OTHER LEGALLY BINDING RESTRICTIONS AS TO USE ARE GIVEN SECOND PRIORITY FOR REPAYMENT IN FULL: AND ANY SPECIAL FUNDS THAT WERE SUBJECT TO ADMINISTRATIVE RESTRICTIONS AS TO USE ARE GIVEN THIRD PRIORITY FOR REPAYMENT IN FULL. FURTHER, IF THE PLAN OF ACTION PROPOSES THAT AMOUNTS BORROWED FROM UNRESTRICTED FUNDS NOT BE REPAID, THE DEPARTMENT OF FINANCE SHOULD OBTAIN RETROACTIVE APPROVAL FROM THE LEGISLATURE FOR THE TRANSFER OF SUCH AMOUNTS.

RESPONSE # 2

We do not concur. We have previously stated **that....**"The amount utilized by the General Fund from Special and Other Funds to pay General Fund obligations was well within our legal authorization, and that the Department did not illegally borrow \$120 million from Special and Other Funds.

3. REQUIRE THE DEPARTMENT OF FINANCE TO REPAY THE \$11.5 MILLION OUTSTANDING BALANCE OF AMOUNTS BORROWED FROM SPECIAL FUNDS IN ACCORDANCE WITH ACT 6068. SPECIFICALLY, THE DEPARTMENT SHOULD SET ASIDE THE NECESSARY GENERAL FUND REVENUES, PROCESS THE APPROPRIATE BANK TRANSACTION TO TRANSFER THE FUNDS FROM THE GENERAL FUND TO THE SPECIAL FUNDS FROM WHICH THE AMOUNTS WERE ORIGINALLY BORROWED, AND PROCESS JOURNAL ENTRY TRANSACTIONS TO RECORD THE REPAYMENT IN THE FINANCIAL MANAGEMENT SYSTEM. IN ADDITION, THE DEPARTMENT OF FINANCE SHOULD PROVIDE A REPORT TO THE LEGISLATURE EXPLAINING THE USES MADE OF THE AMOUNTS BORROWED IN ACCORDANCE WITH ACT NO. 6068 AND THE STATUS OF REPAYMENT SO THAT INFORMED DECISIONS ON THE GOVERNMENT'S FINANCES CAN BE MADE AS THEY PERTAIN TO THE FUND ACCOUNTS AFFECTED BY THIS AUTHORIZED INTERFUND DEBT.

RESPONSE # 3

We concur. A repayment schedule will be developed to repay the \$11.5 million outstanding balance of amounts borrowed from Special Funds in accordance with Act No. 6068.

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4. REQUIRE THE DEPARTMENT OF FINANCE TO ESTABLISH A SEPARATE BANK ACCOUNT AT A SUITABLE LOCAL BANKING INSTITUTION TO SEGREGATE AND SEPARATELY ACCOUNT FOR ALL FEDERAL FUNDS RECEIVED AND ALL EXPENDITURES OF FEDERAL FUNDS MADE BY THE GOVERNMENT. IN ADDITION, THE DEPARTMENT OF FINANCE SHOULD TRANSFER TO THE NEW BANK ACCOUNT ALL AMOUNTS CURRENTLY MAINTAINED IN THE SPECIAL AND OTHER FUNDS BANK ACCOUNTS THAT WERE FROM FEDERAL SOURCES. FURTHER, THE DEPARTMENT SHOULD AMEND ALL **DRAWDOWN** AGREEMENTS WITH FEDERAL GRANTOR AGENCIES TO ENSURE THAT FUTURE **DRAWDOWNS**, WHETHER MADE BY ELECTRONIC FUND TRANSFERS OR BY ANY OTHER MEANS ARE DEPOSITED INTO THE NEW BANK ACCOUNT.

RESPONSE # 4

We concur. The Department of Finance recognizes that for better control of Federal Funds, a separate bank account would assist us in this endeavor. That account has been established and will become operational October 1, 1998.

5. REQUIRE THE DEPARTMENT OF FINANCE TO CONSOLIDATE THE "OLD" AND "NEW" SPECIAL AND OTHER FUNDS CHECKING ACCOUNTS MAINTAINED AT BANCO POPULAR DE PUERTO RICO'S ST. THOMAS BRANCH.

RESPONSE # 5

We concur. The process of reconciliation and accounting of bank activity **is** being performed and efforts being made to consolidate the bank account will be accomplished soon.

6. REQUIRE THE DEPARTMENT OF FINANCE TO ANALYZE ANY UNIDENTIFIED ELECTRONIC FUND TRANSFERS OF FEDERAL FUNDS IN THE TWO EXISTING SPECIAL AND OTHER FUNDS BANK ACCOUNTS TO IDENTIFY THE SOURCE AND APPROPRIATE FUND ACCOUNT TO WHICH EACH TRANSFER SHOULD BE RECORDED AND PROCESS JOURNAL ENTRY TRANSACTIONS TO RECORD SUCH ELECTRONIC FUND TRANSFERS IN THE FINANCIAL MANAGEMENT SYSTEM.

RESPONSE # 6

We concur. The Department of Finance has experienced problems recording certain Federal electronic fund transfers. This occurs when the wire information received from the bank does not include sufficient information to identify the Federal program. The Department has attempted to remedy this problem through the issuance of policy memoranda to departments and agencies on **drawdown** requests. Our efforts continue in this regard.

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7. REQUIRE THE DEPARTMENT OF FINANCE TO TRANSFER \$6 MILLION FROM ANY "AVAILABLE" SPECIAL FUNDS TO THE GENERAL FUND IN ACCORDANCE WITH ACT NO. 6078 AND TO PROCESS JOURNAL ENTRIES TO RECORD THE TRANSFER IN THE FINANCIAL MANAGEMENT SYSTEM. IN ADDITION, THE DEPARTMENT SHOULD PROVIDE A REPORT TO THE LEGISLATURE EXPLAINING THE USES MADE OF THE AMOUNTS TRANSFERRED IN ACCORDANCE WITH ACT NO. 6078 SO THAT INFORMED DECISIONS ON THE GOVERNMENT'S FINANCES CAN BE MADE AS THEY PERTAIN TO THE FUND ACCOUNTS AFFECTED BY THIS AUTHORIZED INTERFUND TRANSFER.

RESPONSE # 7

We concur. The Department of Finance will continue to review the activity between General Fund and Special and Other Funds to assure all applicable transfers are recorded. We have implemented processes to timely capture and record transfers due to/from appropriate funds.

8. ESTABLISH, JOINTLY WITH THE LEGISLATURE AND WITH PARTICIPATION BY PRIVATE SECTOR REPRESENTATIVES, A SPECIAL TASK FORCE TO ADDRESS AND DEVELOP A PLAN OF ACTION TO LIQUIDATE THE GOVERNMENT'S \$588 MILLION (AS OF SEPTEMBER 30, 1997) OUTSTANDING OPERATIONS-RELATED OBLIGATIONS.

RESPONSE # 8

We concur. The Department of Finance will cooperate with any and all Government of the Virgin Islands entities to resolve prior, current and on-going Financial Accountability and Reporting requirements necessary to liquidate outstanding operation-related obligations.

FEDERAL GRANT BALANCES

RESPONSES TO RECOMMENDATIONS

We recommend that the Governor of the Virgin Islands:

1. REQUIRE THE OFFICE OF MANAGEMENT AND BUDGET TO DEVELOP AND IMPLEMENT A **COMPREHENSIVE** FEDERAL GRANT MANAGEMENT SYSTEM THAT REQUIRES ALL GOVERNMENT AGENCIES TO PROVIDE THE OFFICE WITH COPIES OF ALL APPLICATIONS FOR FEDERAL GRANTS AND OTHER GRANT AWARD AND **DRAWDOWN** INFORMATION, USES THIS INPUT FROM GOVERNMENT AGENCIES AS THE BASIS FOR A FEDERAL GRANT DATABASE THAT INCLUDES, FOR EACH GRANT, THE GRANT PROGRAM NAME, THE CATALOG OF FEDERAL DOMESTIC ASSISTANCE (CFDA) NUMBER, THE FEDERAL GRANTOR AGENCY NAME, THE GRANTOR AGENCY'S INTERNAL GRANT NUMBER, THE VIRGIN ISLANDS GRANTEE AGENCY NAME, THE VIRGIN ISLANDS FINANCIAL MANAGEMENT ACCOUNT NUMBER, THE GRANT PERIOD, THE TOTAL GRANT AWARD AMOUNT, THE TOTAL AMOUNT OF **DRAW-DOWNS** MADE AGAINST THE GRANT, AND COPIES OF ANNUAL FINANCIAL REPORTS; MONITORS THE USE OF FEDERAL GRANT FUNDS WITHIN REQUIRED TIME FRAMES AND COMPLIANCE WITH LOCAL MATCHING REQUIREMENTS, AND ENSURES THAT GOVERNMENT AGENCIES SUBMIT REQUIRED ANNUAL AND OTHER GRANT FINANCIAL STATUS REPORTS IN A TIMELY MANNER.

RESPONSE # 1

The Office of Management & Budget has implemented a procedure which requires all Virgin Islands Government Departments and Agencies to forward all information

on federally funded programs. This information is compiled by individual departments and in summary. OMB compiles a report to indicate Grant award date (Start & End), Grant award amount, Amount drawn against the award, Amount expended against the draw and total balance. These reports are to be compiled on a quarterly basis. The office is in process of finalizing the report as of March 31, 1998.

2. REQUIRE THE OFFICE OF MANAGEMENT AND BUDGET TO PROVIDE THE FEDERAL GRANTS MANAGEMENT UNIT WITH THE STAFF AND RESOURCES NECESSARY FOR EFFECTIVE IMPLEMENTATION OF THE RECOMMENDED COMPREHENSIVE FEDERAL GRANT MANAGEMENT SYSTEM.

RESPONSE # 2.

To date, the Office of Federal Grant Management has filled all existing positions except one. The position is expected to be filled shortly. Currently the unit has four Senior Grants Analysts. At the time for the audit, the unit had only two Grant Analysts. With a full complement of positions, the unit will implement and maintain an effective comprehensive Grant Management System.

3. REQUIRE THE DEPARTMENT OF FINANCE TO ESTABLISH PROCEDURES AS A PART OF THE ACCOUNTING MANUAL, TO ENSURE THAT ELECTRONIC FUND TRANSFERS ARE PROMPTLY IDENTIFIED AND RECORDED, THROUGH THE USE OF STATEMENT OF REMITTANCES, TO THE APPROPRIATE FUND ACCOUNTS UPON RECEIPT FROM THE FEDERAL GRANTOR AGENCIES OR ANY OTHER SOURCES. THE PROCEDURES SHOULD REQUIRE GOVERNMENT AGENCIES THAT RECEIVE MONIES THROUGH ELECTRONIC FUND TRANSFERS TO PROVIDE THE DEPARTMENT OF FINANCE, IMMEDIATELY UPON NOTIFICATION FROM THE FEDERAL GRANTOR AGENCY OR OTHER SOURCE, WITH PHOTOSTATIC COPIES OF APPROVED ELECTRONIC FUND TRANSFER DOCUMENTS AND ANY OTHER PERTINENT INFORMATION NEEDED BY THE DEPARTMENT OF FINANCE TO RECORD THE TRANSFERS IN THE FINANCIAL MANAGEMENT SYSTEM.

RESPONSE # 3

We concur. As we have said before, the Department of Finance has experienced problems recording Federal electronic fund transfers. The Department also concurs that there are unusual circumstances where a department or agency had initiated **drawdown** requests prior to the Department of Finance completing its payment process. However, this is the exception. The Department implemented a new process on April 30, 1998, that allows departments and agencies to make drawdowns based on a system generated report which details all payments processed by the Department for their Federal program.

4. REQUIRE THE DEPARTMENT OF FINANCE TO ESTABLISH PROCEDURES TO DETERMINE THE AMOUNT OF INTEREST INCOME EARNED ON FUTURE ELECTRONIC TRANSFERS OF FEDERAL FUNDS THAT ARE NOT IMMEDIATELY RELEASED FOR PAYMENT AND REMIT THE INTEREST INCOME AMOUNTS TO THE U. S. TREASURY AS REQUIRED BY THE CODE OF FEDERAL REGULATIONS (31CFR 205).

RESPONSE # 4

We concur. The Department will establish procedures to identify and capture applicable interest due to timing differences for both expenditures incurred and unfunded as well as income received for payments not disbursed during the established CMIA policy.

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5. REQUIRE THE TRANSPORTATION OFFICE, DEPARTMENT OF PUBLIC WORKS, TO MAINTAIN, FOR FEDERAL GRANTS THAT IT ADMINISTERS, FEDERAL GRANT PROGRAM FILES WHICH INCLUDE COPIES OF ALL APPLICATIONS FOR FEDERAL GRANTS, AWARD, DRAWDOWN, AND OTHER PERTINENT GRANT MANAGEMENT INFORMATION, AND COPIES OF GRANT FINANCIAL STATUS REPORTS.

RESPONSE # 5.

The Department of Public Works has taken steps to implement a corrective action plan to effectively manage the grant programs. The Certified Public Accountant Firm of Bronstein, Benham and Gillettee, P. C. has been contracted to develop a federal grant permanent file for the Transportation Office. The permanent file will include: (1) specific compliance requirements of each grant, (2) federal restrictions on expenditures and revenue drawdowns including allowability of indirect costs, (3) Office of Management and Budget Circular A-128 (Fiscal Year 1996) and OMB Circular A-133 (Fiscal Year 1997) requirements and (4) corrective action plans for Single Audit Findings for specific programs.

6. REQUIRE THE DEPARTMENT OF PUBLIC WORKS TO DEVELOP A PLAN OF ACTION TO EFFECTIVELY USE FEDERAL TRANSIT ADMINISTRATION, FEDERAL HIGHWAY ADMINISTRATION, AND U. S. ENVIRONMENTAL PROTECTION AGENCY FUNDS THAT ARE AVAILABLE FOR APPROVED PROJECTS.

RESPONSE # 6.

We concur. The Department of Public Works is in the process of developing a plan of action to effectively use Federal Transit Administration, Federal Administration, and U. S. Environmental Protection Agency funds that are available for approved projects. Working along with our consultants, we are hoping to be able to accomplish this goal within the next fiscal year.

7. REQUIRE THE DEPARTMENT OF EDUCATION, IN COOPERATION WITH THE DEPARTMENT OF PROPERTY AND PROCUREMENT, TO UNDERTAKE A STUDY OF ITS INTERNAL REQUISITION AND VENDOR PAYMENT PROCESSES, WITH THE OBJECTIVE OF STREAMLINING AND AUTOMATING AS MANY FUNCTIONS AS POSSIBLE. ALSO, SUFFICIENT INTERNAL CONTROLS SHOULD BE INSTITUTED TO SAFEGUARD AGAINST UNAUTHORIZED OR IMPROPER PURCHASES OF GOODS AND SERVICES AND PAYMENTS TO VENDORS.

RESPONSE # 7.

We concur. Over two months, the Department of Education, in coordination with the Departments of Property and Procurement and Finance instituted the Infrastructure Tracking System which is intended to improve the procurement operations within the Department and expedite the requisition and vendor payment processes. This Tracking System is fully automated from the point of the originators of requisitions to the transmittal to the Departments of Property and Procurement and Finance. Internal controls have been put in place to safeguard against unauthorized and improper purchases of goods and services and payment to vendors.

Honorable Robert J. Williams

(9)

August 7, 1998

LONG-STANDING PROBLEMS

RESPONSES TO RECOMMENDATIONS

We recommend that the Governor of the Virgin Islands:

1. REQUIRE THE DEPARTMENT OF FINANCE TO PERFORM AN ASSESSMENT OF THE CURRENT AND PROJECTED FUTURE FINANCIAL ACCOUNTING AND REPORTING NEEDS OF THE GOVERNMENT AND SEED THE FUNDING NECESSARY TO UPGRADE THE FINANCIAL MANAGEMENT SYSTEM'S COMPUTER AND SOFTWARE ACCORDINGLY. IN PERFORMING THE NEEDS ASSESSMENT, INPUT SHOULD OBTAINED FROM ALL USER AGENCIES AND SUCH FACTORS AS THE NUMBER OF ON-LINE USERS, THE VOLUME OF TRANSACTIONS, COMPLIANCE WITH THE FINANCIAL REPORTING REQUIREMENTS OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND THE SINGLE AUDIT ACT, AND THE SPECIAL FINANCIAL INFORMATION NEEDS AND REPORTING REQUIREMENTS OF AGENCY MANAGEMENT SHOULD BE CONSIDERED. ALSO, PROVISIONS SHOULD BE MADE TO ENSURE THAT USERS ARE PROPERLY TRAINED AND THAT A USER-FRIENDLY OPERATING MANUAL FOR THE FINANCIAL MANAGEMENT SYSTEM IS DEVELOPED AND DISTRIBUTED TO ALL USERS.

RESPONSE # 1

We concur. The Department has begun to implement long-range planning strategies to address the current and projected future accounting and reporting needs of the Government of the Virgin Islands. Additionally, efforts are in process to identify funding and contractual resources to assist with the upgrading and maintenance of the Financial Management System's (FMS) automated technology in the broader scope of hardware and software platforms.

2. DEVELOP AND IMPLEMENT AN AUDIT FOLLOWUP SYSTEM TO ENSURE THAT AGENCIES IMPLEMENT AGREED-TO AUDIT RECOMMENDATIONS (WHETHER MADE BY THE OFFICE OF INSPECTOR GENERAL, THE VIRGIN ISLANDS BUREAU OF AUDIT AND CONTROL, INTERNAL AUDITORS, OR CONTRACTED INDEPENDENT AUDITORS) OR PROVIDE REASONABLE JUSTIFICATION AS TO WHY THE RECOMMENDATIONS CANNOT OR SHOULD NOT BE IMPLEMENTED. AS OPTIONS, THE BUDGET PROCESS COULD BE USED TO PROVIDE INCENTIVES FOR AGENCIES TO FULLY IMPLEMENT AUDIT RECOMMENDATIONS AND/OR THE SPECIAL ASSISTANT TO THE GOVERNOR FOR POLICY AND AUDIT RESOLUTION COULD REPORT TO THE GOVERNOR, ON AT LEAST A SEMIANNUAL BASIS, THE AGENCIES THAT DID NOT IMPLEMENT AUDIT RECOMMENDATIONS SO THAT THE GOVERNOR COULD FOLLOW UP WITH THE AGENCY HEADS TO REQUIRE IMPLEMENTATION.

RESPONSE # 2

We concur. We are developing a Quality Assurance Unit within the Department of Finance to provide the additional monitoring, procedural and review activities relative to the administration and conduct of operational units which internally and externally impact the timeliness of all financial reporting.

Honorable Robert J. Williams

(10)

August 7, 1998

3. REQUIRE AND PROVIDE THE DEPARTMENT OF PROPERTY AND PROCUREMENT WITH THE AUTHORITY TO STRICTLY ENFORCE COMPETITIVE PROCUREMENT REQUIREMENTS. TO THE MAXIMUM EXTENT POSSIBLE, ADVERTISED INVITATIONS FOR BIDS SHOULD BE USED FOR THE PROCUREMENT OF GOODS AND CONSTRUCTION SERVICES. IN INSTANCES WHERE EMERGENCY OR OTHER CIRCUMSTANCES MAKE FORMAL ADVERTISED BIDS IMPRACTICAL FOR CONSTRUCTION CONTRACTS AND FOR ALL PROFESSIONAL SERVICES CONTRACTS, REQUESTS FOR PROPOSALS AND COMPETITIVE NEGOTIATIONS SHOULD BE USED BY FOLLOWING THE REQUIREMENTS ESTABLISHED IN TITLE 31, SECTION 239 (10), OF THE VIRGIN ISLANDS CODE AND TITLE 31, SECTION 239-4, OF THE VIRGIN ISLANDS RULES AND REGULATIONS. ALSO, SPECIAL CONTINGENCY PLANS SHOULD BE DEVELOPED TO PROVIDE A MECHANISM FOR THE GOVERNMENT, WITH A REASONABLE LEVEL OF COMPETITION AND MANAGEMENT OVERSIGHT, TO OBTAIN EMERGENCY DEBRIS REMOVAL AND REPAIR SERVICES IN THE EVENT OF FUTURE HURRICANES OR OTHER NATURAL DISASTERS.

RESPONSE # 3

We concur. Title 31, Section 239 (10) of the Virgin Islands Code spell out the requirements for competitive procurement. This authority is given to the Commissioner of Property and Procurement. I have directed the Commissioner to strictly enforce the letter of the law. The Commissioner has assured me that in accordance with law, advertised invitations for bids are being used for the procurement of goods and construction services.

Plans are being developed to provide a mechanism for the government to provide for a reasonable level of competition and management oversight during hurricanes.

4. ESTABLISH AN INTERAGENCY TASK FORCE, IN COORDINATION WITH A COMPETITIVELY SELECTED OUTSIDE COLLECTION AGENCY, TO REVIEW AND UPDATE THE ACCOUNTS RECEIVABLE RECORDS OF ALL REVENUE-GENERATING AGENCIES OF THE GOVERNMENT; WRITE OFF ACCOUNTS THAT ARE DEEMED TO BE UNCOLLECTIBLE; ATTEMPT TO COLLECT OUTSTANDING ACCOUNTS THAT ARE DEEMED TO BE COLLECTIBLE; AND ESTABLISH PROCEDURES TO ENSURE THAT BILLS ARE PROMPTLY ISSUED FOR ALL AMOUNTS OWED THE GOVERNMENT, ACCOUNTS RECEIVABLE RECORDS ARE KEPT UP TO DATE, AND EFFECTIVE COLLECTION ENFORCEMENT ACTIONS ARE UNDERTAKEN FOR ALL AMOUNTS OWED THE GOVERNMENT. ALSO, A CONTROL MECHANISM SHOULD BE ESTABLISHED THAT WOULD REQUIRE EACH REVENUE-GENERATING AGENCY OF THE GOVERNMENT TO SUBMIT A QUARTERLY REPORT TO THE OFFICE OF MANAGEMENT AND BUDGET WHICH IDENTIFIES THE OUTSTANDING BALANCE OF ACCOUNTS RECEIVABLE FOR EACH TYPE OF REVENUE COLLECTED BY THE AGENCY AND REQUIRE THE OFFICE OF MANAGEMENT AND BUDGET TO SUMMARIZE THIS INFORMATION, AT LEAST ON A SEMIANNUAL BASIS, IN A REPORT TO THE GOVERNOR OF ANY AGENCY THAT WAS ALLOWING ITS ACCOUNTS RECEIVABLE BALANCES TO INCREASE SIGNIFICANTLY.

RESPONSE # 4

We concur. This Administration is committed to developing a mechanism for the implementation of this recommendation. The Office of Management and Budget is pursuing a request to the U. S. Department of Interior for a grant to hire the necessary staff within the Office of Management and Budget to accomplish the responsibilities spelled out in your recommendation.

Honorable Robert J. Williams

(11)

5. REQUIRE THE DIVISION OF PERSONNEL, IN COOPERATION WITH THE OFFICE OF COLLECTIVE BARGAINING AND WITH PARTICIPATION BY EMPLOYEE UNION REPRESENTATIVES, TO UNDERTAKE A COMPREHENSIVE REVIEW OF THE EXISTING PERSONNEL MERIT SYSTEM TO INCLUDE DEVELOPING RULES AND REGULATIONS FOR COLLECTIVE BARGAINING; UPDATING JOB CLASSIFICATIONS AND JOB DESCRIPTIONS; CONSOLIDATING THE GOVERNMENT'S MANY SALARY AND WAGE SCHEDULES; AND RESOLVING CONFLICTS BETWEEN EXISTING LAWS CONCERNING THE TYPES OF POSITIONS THAT CAN BE FILLED THROUGH APPOINTMENTS TO UNCLASSIFIED POSITIONS.

RESPONSE # 5.

We concur. The Division of Personnel has been working with the Office of Management and Budget and the Office of Collective Bargaining to establish a uniform listing of position classes within the merit system. We have developed rules and regulations which govern relationships among the Division of Personnel, the Office of Collective Bargaining, and union representatives.

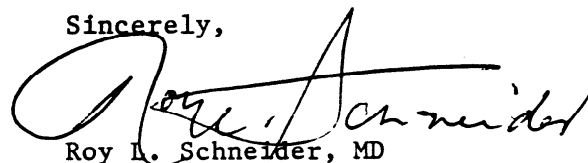
We have enclosed the following Exhibits for your information and review:

- (1) Exhibit 1 - Analysis of Federal Expenditures vs. Drawdowns, Department of Public Works, October 1, 1995 through July 31, 1997
- (2) Exhibit 2 - Analysis of Special and Other Funds Cash Balances

In conclusion, you may count on our continued cooperation in resolving any further issues of this Draft Report.

Should you have any additional questions, please feel free to contact my office.

Sincerely,



Roy L. Schneider, MD
Governor

cc: Juan Centeno
Commissioner of Finance

Arnold E. vanBeverhoudt, Jr.
Director of Insular Area Audits

Elmo D. Roebuck
Special Assistant to the Governor
Audits & Policy Evaluation

Nellon Bowry, Director
Office of Management & Budget

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
A.1, A.3, A.6, A.7, and A.8	Management concurs; additional information needed.	Provide an action plan that includes a target date for implementing each recommendation.
A.2	Unresolved.	Reconsider the recommendation and provide a response that addresses the actions to be taken to liquidate the \$120 million in loans from the Special and Other Funds. If concurrence is indicated, provide an action plan that includes a target date and the title of the official responsible for implementation. If nonconcurrence is indicated, provide specific reasons for the nonconcurrence.
A.4 and A.5	Implemented.	No further action required.
B.1, B.2, B.3, and B.7	Implemented.	No further action required.
B.4, B.5, and B.6	Management concurs; additional information needed.	Provide an action plan that includes a target date for implementing each recommendation.
C.1, C.3, and C.4	Management concurs; additional information needed.	Provide an action plan that includes a target date for implementing each recommendation.

Finding/Recommendation Reference	Status	Action Required
c.2	Unresolved.	Reconsider the recommendation and provide a response that addresses the actions to be taken to develop a comprehensive audit followup system. If concurrence is indicated, provide an action plan that includes a target date and the title of the official responsible for implementation. If nonconcurrence is indicated, provide specific reasons for the nonconcurrence.
C.5	Unresolved.	Reconsider the recommendation and provide a response that addresses the actions to be taken to perform a comprehensive review and upgrade of the personnel merit system. If concurrence is indicated, provide an action plan that includes a target date and the title of the official responsible for implementation. If nonconcurrence is indicated, provide specific reasons for the nonconcurrence.

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